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PRIVATELY FINANCED INFRASTRUCTURE PROJECTS

Draft chapters of a legislative guide on privately financed infrastructure projects

Report of the Secretary-General

Addendum

II. PROJECT RISKS AND GOVERNMENT SUPPORT

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LEGISLATIVE RECOMMENDATIONS

1. Project risks and risk allocation (see paras. 3-24)

1. The extent and nature of risks assumed by the project company and the contracting authority, respectively, should be set forth in the project agreement and related documentation. The host country may wish to consider removing unnecessary statutory or regulatory limitations to the contracting authority's ability to agree on an allocation of risks that, in the view of the contracting authority, is suited to the needs of the project.

2. Government support (see paras. 25-56)

2. The host country may wish to consider adopting legislative provisions indicating the forms of financial support that the Government is authorized to provide.

NOTES ON THE LEGISLATIVE RECOMMENDATIONS

A. General remarks

1. Privately financed infrastructure projects create opportunities for reducing the commitment of public funds and other resources for infrastructure development and operation. They also make it possible to transfer to the private sector a number of risks that would otherwise be borne by the Government. The precise allocation of risks among the various parties involved is typically defined after consideration of a number of factors, including the public interest in the development of the infrastructure in question and the level of risk faced by the project company, other investors and lenders (and the extent of their ability and readiness to absorb those risks at an acceptable cost). Adequate risk allocation is essential to reducing project costs and to ensuring the successful implementation of the project. Conversely, an inappropriate allocation of project risks may compromise the project's financial viability or hinder its efficient management, thus increasing the cost at which the service is provided.

2. Section B of the present chapter (see paras. 3-24) gives an overview of the main risks encountered in privately financed infrastructure projects and a brief discussion of common contractual solutions for risk allocation, which emphasizes the need for providing the parties with the necessary flexibility for negotiating a balanced allocation of project risks. Section C (see paras. 25-56) sets out policy considerations the Government may wish to take into account when designing the level of direct governmental support that may be provided to infrastructure projects, such as degree of public interest in the execution of any given project, and the need to avoid the assumption by the Government of open-ended or excessive contingent liabilities. Section C considers some additional support measures that have been used in governmental programmes to promote private investment in infrastructure development, without advocating the use of any of them in particular. Lastly, sections D (see paras. 57-67) and E (see paras. 68-70) outline guarantees and support measures that may be provided by international and bilateral financial institutions.

B. Project risks and risk allocation

3. As used in this chapter, the notion of "project risks" refers to those circumstances which, in the assessment of the parties, may have a negative effect on the benefit they expected to achieve with the project. While there may be events that would represent a serious risk for most parties (e.g. the physical destruction of the facility by a natural disaster), each party's risk exposure will vary according to its role in the project.

4. The expression "risk allocation" refers to the determination of which party or parties should bear the consequences of the occurrence of events identified as project risks. For example, if the project company is obliged to deliver the infrastructure facility to the contracting authority with certain equipment in functioning condition, the project company is bearing the risk that the equipment may fail to function at the agreed performance levels. The occurrence of that project risk, in turn, may have a series of consequences for the project company, including its liability for failure to perform a contractual obligation under the project agreement or the applicable law (e.g. payment of damages to the contracting authority for delay in bringing the facility into operation); loss (e.g. loss of revenue as a result of delay in beginning operating the facility); or additional cost (e.g. cost of repair of faulty equipment or of securing replacement equipment).

5. The party bearing a given risk may take preventive measures with a view to limiting the likelihood of the risk, as well as specific measures to protect itself, in whole or in part, against the consequences of the risk. Such measures are often referred to as "risk mitigation". In the previous example, the project company will carefully review the reliability of the equipment suppliers and the technology proposed. The project company may require its equipment suppliers to provide independent guarantees concerning the performance of their equipment. The

supplier may also be liable to pay penalties or liquidated damages to the project company for the consequences of failure of its equipment. In some cases, a more or less complex chain of contractual arrangements may be made to mitigate the consequences of a project risk. For instance, the project company may combine the guarantees provided by the equipment supplier with commercial insurance covering some consequences of the interruption of its business as a result of equipment failure.

1. Overview of main categories of project risk

6. For purposes of illustration, the following paragraphs provide an overview of the main categories of project risk and illustrate certain contractual arrangements used for risk allocation and mitigation. For further discussion on this subject, the reader is advised to consult other sources of information, such as the *Guidelines for Infrastructure Development through Build-Operate-Transfer (BOT) Projects* prepared by the United Nations Industrial Development Organization.[1]

(a) Project disruption caused by events outside the control of the parties

7. The parties face the risk that the project may be disrupted by unforeseen or extraordinary events outside their control, which may be of a physical nature, such as natural disasters—floods, storms or earthquakes—or the result of human action, such as war, riots or terrorist attacks. Such unforeseen or extraordinary events may cause a temporary interruption of the project execution or the operation of the facility, resulting in construction delay, loss of revenue and other losses. Severe events may cause physical damage to the facility or even destruction beyond repair.

(b) Project disruption caused by adverse acts of Government ("political risk")

8. The project company and the lenders face the risk that the project execution may be negatively affected by acts of the contracting authority, other agency of the Government or the host country's legislature. Such risks are often referred to as "political risks" and may be divided into three broad categories: "traditional" political risks (e.g. nationalization of the project company's assets or imposition of new taxes that jeopardize the project company's prospects of debt repayment and investment recovery); regulatory risks (e.g. introduction of more stringent standards for service delivery or opening of a sector to competition) and "quasi-commercial" risks (e.g. breaches by the contracting authority or project interruptions due to changes in the contracting authority's priorities and plans). In addition to political risks originating from the host country, some political risks may result from acts of a foreign Government, such as blockades, embargoes or boycotts imposed by the Governments of the investors' home countries.

(c) Construction and operation risks

9. The main risks that the parties may face during the construction phase are the risks that the facility cannot be completed at all or cannot be delivered according to the agreed schedule (completion risk); that the construction cost exceeds the original estimates (construction cost-overrun risk); or that the facility fails to meet performance criteria at completion (performance risk). Similarly, during the operational phase the parties may face the risk that the completed facility cannot be effectively operated or maintained to produce the expected capacity, output or efficiency (performance risk); or that the operating costs exceed the original estimates (operation cost-overrun). It should be noted that construction and operation risks do not affect only the private sector. The contracting authority and the users in the host country may be severely affected by an interruption in the provision of needed services.

10. Some of these risks may be brought about by the project company or its contractors or suppliers. For instance, construction cost-overrun and delay in completion may be the result of inefficient construction

practices, waste, insufficient budgeting or lack of coordination among contractors. Failure of the facility to meet performance criteria may also be the result of defective design, inadequacy of the technology used or faulty equipment delivered by the project company's suppliers. During the operational phase, performance failures may be the consequence, for example, of faulty maintenance of the facility or negligent operation of mechanical equipment. Operation cost-overruns may also derive from inadequate management.

11. However, some of these risks may also result from specific actions taken by the contracting authority, by other governmental agencies or even the host country's legislature. Performance failures or cost-overruns may be the consequence of the inadequacy of the technical specifications provided by the contracting authority during the selection of the concessionaire. Delays and cost-overruns may also be brought about by actions of the contracting authority subsequent to the award of the project (delays in obtaining approvals and permits, additional costs caused by changes in requirements due to inadequate planning, interruptions caused by inspecting agencies or delays in delivering the land on which the facility is to be built). General legislative or regulatory measures, such as more stringent safety or labour standards, may also result in higher construction or operating costs. Shortfalls in production may be caused by the non-delivery of the necessary supplies (e.g. power or gas) on the part of public authorities.

(d) Commercial risks

12. "Commercial risks" relate to the possibility that the project cannot generate the expected revenue because of changes in market prices or demand for the goods or services it generates. Both of these forms of commercial risk may seriously impair the project company's capacity to service its debt and may compromise the financial viability of the project.

13. Commercial risks vary greatly according to the sector and type of project. The risk may be regarded as minimal or moderate where the project company has a monopoly over the service concerned or when it supplies a single client through a standing off-take agreement. However, commercial risks may be considerable in projects that depend on market-based revenues, in particular where the existence of alternative facilities or supply sources makes it difficult to establish a reliable forecast of usage or demand. This may be a serious concern, for instance, in tollroad projects, since tollroads face competition from toll-free roads. Depending on the ease with which drivers may have access to toll-free roads, the toll revenues may be difficult to forecast, especially in urban areas where there may be many alternative routes and roads may be built or improved continuously. Furthermore, traffic usage has been found to be even more difficult to forecast in the case of new tollroads, especially those which are not an addition to an existing toll facility system, because there is no existing traffic to use as a historical basis.

(e) Exchange rate and other financial risks

14. Exchange rate risk relates to the possibility that changes in foreign exchange rates alter the currency value of cash flows from the project. Tariffs and user fees charged to local users or customers will most likely be paid for in local currency, while the loan facilities and sometimes also equipment or fuel costs may be denominated in foreign currency. This risk may be considerable, since exchange rates are particularly unstable in many developing countries. In addition to exchange rate fluctuations, the project company may face the risk that foreign exchange control or lowering reserves of foreign exchange may limit the availability in the local market of foreign currency needed by the project company to service its debt or repay the original investment.

15. Another risk faced by the project company concerns the possibility that interest rates may rise, forcing the project to bear additional financing costs. This risk may be significant in infrastructure projects given the usually large sums borrowed and the long duration of the project, with some loans extending over a period of several years. Where necessary, the debt can be raised at a fixed rate of interest (e.g. fixed rate bonds) to reduce the

interest rate risk. In addition, the finance package may include hedging facilities against interest rate risks, for example, by way of interest rate swaps or interest rate caps.

2. Contractual arrangements for risk allocation and mitigation

16. The risk allocation eventually agreed to by the contracting authority and the project company will be reflected in their mutual rights and obligations, as set forth in the project agreement. The possible legislative implications of certain provisions commonly found in project agreements are discussed in other chapters of the *Guide* (see chaps. IV, "The project agreement", V, "Infrastructure development and operation", and VI, "End of project term, extension and termination"). Various other agreements will also be negotiated by the parties to mitigate or reallocate the risks they assume (e.g. loan agreements; construction, equipment supply, operation and maintenance contracts; direct agreement between the contracting authority and the lenders; and off-take and long-term supply agreements, where applicable).

17. Practical guidance provided to negotiators in a number of countries often refers to general principles for the allocation of project risks. One such principle is that specific risks should normally be allocated to the party best able to assess, control and manage the risk. Additional guiding principles envisage the allocation of project risks to the party with the best access to hedging instruments or the greatest ability to diversify the risks or to mitigate them at the lowest cost. In practice, however, risk allocation is often a factor of both policy considerations (e.g. the public interest in the project or the overall exposure of the contracting authority under various projects) and the negotiating strength of the parties. Furthermore, in allocating project risks it is important to consider the financial strength of the parties to which a specific risk is allocated and their ability to bear the consequences of the risk, should it occur.

18. It is usually for the project company and its contractors to assume ordinary risks related to the development and operation of the infrastructure. For instance, completion, cost-overrun and other risks typical of the construction phase are usually allocated to the construction contractor or contractors through a turnkey construction contract, whereby the contractor assumes full responsibility for the design and construction of the facility at a fixed price, within a specified completion date and according to particular performance specifications (see chap. V, "Infrastructure development and operation", ___). The construction contractor is typically liable to pay liquidated damages or penalties for any late completion. In addition, the contractor is also usually required to provide a guarantee of performance, such as a bank guarantee or a surety bond. Separate equipment suppliers are also usually required to provide guarantees in respect of the performance of their equipment. Similarly, the project company typically mitigates its exposure to operation risks by entering into an operation and maintenance contract in which the operating company undertakes to achieve the required output and assumes the liability for the consequences of operational failures. In most cases, arrangements of this type will be an essential requirement for a successful project. The lenders, for their part, will seek protection against the consequences of those risks, by requiring the assignment of the proceeds of any bonds issued to guarantee the contractor's performance, for instance.

19. The contracting authority, on the other hand, will be expected to assume those risks which relate to events attributable to its own actions, such as inadequacy of technical specifications provided during the selection process or delay caused by failure to provide agreed supplies on time. The contracting authority may also be expected to bear the consequences of disruptions caused by acts of Government, for instance by agreeing to compensate the project company for loss of revenue due to price control measures (see chap. V, "Infrastructure development and operation", ___). While some political risks may be mitigated by procuring insurance, such insurance, if at all available for projects in the country concerned, may not be obtainable at an acceptable cost. Thus, prospective investors and lenders may turn to the Government, for instance, to obtain assurances against expropriation or nationalization and guarantees that proper compensation will be payable in the event of such

action (see para. 45). Depending on their assessment of the level of risk faced in the host country, prospective investors and lenders may not be ready to pursue a project in the absence of those assurances or guarantees.

20. Most of the project risks referred to in the preceding paragraphs can, to a greater or lesser extent, be regarded as falling within the control of one party or the other. However, a wide variety of project risks result from events outside the control of the parties or are attributable to the acts of third parties and other principles of risk allocation may thus need to be considered.

21. For example, the financing documentation usually provides for a floating rate of interest, which protects the lenders from interest rate risks, but it may be possible for the project company to hedge against higher interest rates through swap agreements to lock into a long-term fixed rate of interest. The project company could expect that this risk, together with the inflation risk, would be passed on to the end-users or customers of the facility through price increases, although this may not always be possible because of market-related circumstances or price control measures. The tariff structure negotiated between the project company and the contracting authority will determine the extent to which the project company will avoid those risks or whether it will be expected to absorb some of them (see chap. IV, "The project agreement", ___).

22. Another category of risk that may be allocated under varying schemes concerns extraneous events such as war, civil disturbance, natural disasters or other events wholly outside the control of the parties. In traditional infrastructure projects carried out by the public sector, the public entity concerned usually bears the risk, for example, of destruction of the facility by natural disasters or similar events, to the extent that those risks may not be insurable. In privately financed infrastructure projects the Government may prefer this type of risk to be borne by the project company. However, depending on their assessment of the particular risks faced in the host country, the private sector may not be ready to bear those risks. Therefore, in practice there is not a single solution to cover this entire category of risk and special arrangements are often made to deal with each of them. For example, the parties may agree that the occurrence of some of those events may exempt the affected party from the consequences of failure to perform under the project agreement and there will be contractual arrangements providing solutions for some of their adverse consequences, such as contract extensions to compensate for delay resulting from events or even some form of direct payment under special circumstances (see chap. V, "Infrastructure development and operation",___). Those arrangements will be supplemented by commercial insurance purchased by the project company, where available at an acceptable cost (see chap. IV, "The project agreement", ___).

23. Special arrangements may also need to be negotiated for the allocation of commercial risks. Projects such as mobile telecommunication projects usually have a relatively high direct cost recovery potential and in most cases the project company is expected to carry out the project without sharing those risks with the contracting authority and without recourse to support from the Government. In other infrastructure projects, such as power-generation projects, the project company may revert to contractual arrangements with the contracting authority or other governmental agency in order to reduce its exposure to commercial risks, for example, by negotiating long-term off-take agreements that guarantee a market for the product at an agreed price. Payments may take the form of actual consumption or availability charges or combine elements of both and the applicable rates are usually subject to escalation or indexation clauses in order to protect the real value of revenues from the increased costs of operating an ageing facility (see also chap. IV, "The project agreement", ___). Lastly, there are relatively capital-intensive projects with more slowly developing cost recovery potential, such as water supply and some tollroad projects, which the private sector may be reluctant to carry out without some form of risk-sharing with the contracting authority, for example, through fixed revenue assurances or agreed capacity payments regardless of actual usage (see also chap. IV, "The project agreement", ___).

24. It follows from the above that the parties need to take into account a wide range of factors to allocate project risks effectively. Although it may be useful for the Government to provide some general guidance to

negotiators acting on behalf of domestic contracting authorities, by formulating advisory principles on risk allocation, for instance, it is generally not advisable to have in place statutory provisions that limit unnecessarily the negotiators' ability to achieve a balanced allocation of project risks, as appropriate to the needs of individual projects.

C. Government support

25. The discussion in the preceding section shows that the parties may use various contractual arrangements to allocate and mitigate project risks. Nevertheless, those arrangements may not always be sufficient to ensure the level of comfort required by private investors to participate in privately financed infrastructure projects. It may also be found that certain additional government support is needed to enhance the attractiveness of private investment in infrastructure projects in the host country.

26. Government support may take various forms. Generally, any measure taken by the Government to enhance the investment climate for infrastructure projects may be regarded as governmental support. From that perspective, the existence of legislation enabling the Government to award privately financed infrastructure projects or the establishment of clear lines of authority for the negotiation and follow-up of infrastructure projects (see chap. I, "General legislative considerations", ___) may represent important measures to support the execution of infrastructure projects. As used in the *Guide*, however, the expression "government support" has a narrower connotation and refers in particular to special measures, in most cases of a financial or economic nature, that may be taken by the Government to enhance the conditions for the execution of a given project or to assist the project company in meeting some of the project risks, above and beyond the ordinary scope of the contractual arrangements agreed to between the contracting authority and the project company to allocate project risks. Government support measures, where available, are typically an integral part of governmental programmes to attract private investment for infrastructure projects.

1. Policy considerations relating to government support

27. In practice, a decision to support the implementation of a project is based on an assessment by the Government of the economic or social value of the project and whether that justifies additional governmental support. The Government may estimate that the private sector alone may not be able to finance certain projects at an acceptable cost. The Government may also consider that particular projects may not materialize without certain support measures that mitigate some of the project risks. Indeed, the readiness of private investors and lenders to carry out large projects in a given country is not only based on their assessment of specific project risks, but is also influenced by their comfort with the investment climate in the host country, in particular in the infrastructure sector. Factors to which private investors may attach special importance include the host country's economic system and the degree of development of market structures and the degree to which the country has already succeeded with privately financed infrastructure projects over a period of years.

28. For the above reasons, a number of countries have adopted a flexible approach for dealing with the issue of governmental support. In some countries, this has been done by legislative provisions that tailor the level and type of support to the specific needs of individual infrastructure sectors. In other countries, this has been achieved by providing the host Government with sufficient legislative authority to extend certain types of assurance or guarantee while preserving its discretion not to make them available in all cases. However, the host Government will be interested in ensuring that the level and type of support provided to the project does not result in the assumption of open-ended liabilities. Indeed, over-commitment of governmental agencies through guarantees given to a specific project may prevent them from extending guarantees in other projects of perhaps even greater public interest.

29. The efficiency of governmental support programmes for private investment in infrastructure may be enhanced by the introduction of appropriate techniques for budgeting for governmental support measures or for assessing the total cost of other forms of governmental support. For example, loan guarantees provided by governmental agencies usually have a cost lower than the cost of loan guarantees provided by commercial lenders. The difference (less the value of fees and interests payable by the project company) represents a cost for the Government and a subsidy for the project company. However, loan guarantees are often not recorded as expenses until such time as a claim is made. Thus, the actual amount of the subsidy granted by the Government is not recorded, which may create the incorrect impression that loan guarantees entail a lesser liability than direct subsidy payments. Similarly, the financial and economic cost of tax exemptions granted by the Government may not be apparent, which makes them less transparent than other forms of direct governmental support. For these reasons, countries that are contemplating establishing support programmes for privately financed infrastructure projects may need to devise special methods for estimating the budgetary cost of support measures such as tax exemptions, loans and loan guarantees provided by governmental agencies that take into account the expected present value of future costs or loss of revenue.

2. Forms of government support

30. The availability of direct governmental support, be it in the form of financial guarantees, public loans or revenue assurances, may be an important element in the financial structuring of the project. The following paragraphs briefly describe forms of governmental support that are sometimes authorized under domestic laws and discuss possible legislative implications they may have for the host country, without advocating the use of any of them in particular.

31. Generally, besides the administrative and budgetary measures that may be needed to ensure the fulfilment of governmental commitments throughout the duration of the project, it is advisable for the legislature to consider the possible need for an explicit legislative authorization to provide certain forms of support. Where government support is found advisable, it is important for the legislature to bear in mind the host country's obligations under international agreements on regional economic integration or trade liberalization, which may limit the ability of governmental agencies of the contracting States to provide financial support to companies operating in their territories. Furthermore, where a Government is contemplating support for the execution of an infrastructure project, that circumstance should be made clear to all prospective bidders at an appropriate time during the selection proceedings (see chap. III, "Selection of the concessionaire", ___).

(a) Public loans and loan guarantees

32. In some cases, the law authorizes the Government to extend interest-free or low-interest loans to the project company to lower the project's financing cost. Depending on the accounting rules to be followed, some interest-free loans provided by public agencies can be recorded as revenue in the project company's accounts, with loan payments being treated as deductible costs for tax and accounting purposes. Moreover, subordinate loans provided by the Government may enhance the financial terms of the project by supplementing senior loans provided by commercial banks without competing with senior loans for repayment. Governmental loans may be generally available to all project companies in a given sector or they may be limited to providing temporary assistance to the project company in the event that certain project risks occur. The total amount of any such loan may be further limited to a fixed sum or to a percentage of the total project cost.

33. In addition to public loans, some national laws authorize the contracting authority or other agency of the host Government to provide loan guarantees for the repayment of loans taken by the project company. Loan guarantees are intended to protect the lenders (and, in some cases, investors providing funds to the project as well) against default by the project company. Loan guarantees do not entail an immediate disbursement of public funds and they may appear more attractive to the Government than direct loans. However, loan

guarantees may represent a substantial contingent liability and the Government's exposure may be significant, especially in the event of total failure by the project company. Indeed, the Government would in most cases find little comfort in a possible subrogation in the rights of the lenders against an insolvent project company.

34. Thus, in addition to introducing general measures to enhance the efficiency of governmental support programmes (see para. 29), it may be advisable to consider concrete provisions to limit the Government's exposure under loan guarantees. Rules governing the provision of loan guarantees may provide a maximum ceiling, which could be expressed as a fixed sum or, if more flexibility is needed, a certain percentage of the total investment in any given project. Another measure to circumscribe the contingent liabilities of the guaranteeing agency may be to define the circumstances under which such guarantees may be extended, taking into account the types of project risk the Government may be ready to share. For instance, if the Government considers sharing only the risks of temporary disruption caused by events outside the control of the parties, the guarantees could be limited to the event that the project company is rendered temporarily unable to service its loans owing to the occurrence of specially designated unforeseeable events outside the project company's control. If the Government wishes to extend a greater degree of protection to the lenders, the guarantees may cover the project company's permanent failure to repay its loans for the same reasons. In such a case, however, it is advisable not to remove the incentives for the lenders to arrange for the continuation of the project, for instance by identifying another suitable concessionaire or by stepping in through an agent appointed to remedy the project company's default (see chap. V, "Infrastructure development and operation", ___). The call on the governmental guarantees could thus be conditional upon the prior exhaustion of other remedies available to the lenders under the project agreement, the loan agreements or their direct agreements with the contracting authority, if any. In any event, full loan guarantees by the Government amounting to a total protection of the lenders against the risk of default by the project company are not a common feature of infrastructure projects carried out under the project finance modality.

(b) Equity participation

35. Another form of additional support by the Government may consist of direct or indirect equity participation in the project company. Equity participation by the Government may help achieve a more favourable ratio between equity and debt by supplementing the equity provided by the project sponsors, in particular where other sources of equity capital, such as investment funds, cannot be tapped by the project company. Equity investment by the Government may also be useful to satisfy legal requirements of the host country concerning the composition of locally established companies. The company laws of some jurisdictions, or special legislation on infrastructure projects, require a certain amount of participation of local investors in locally established companies. However, it may not always be possible to secure the required level of local participation on acceptable terms. Local investors may lack the interest or financial resources to invest in large infrastructure projects; they may also be averse to or lack experience in dealing with specific project risks.

36. Governmental participation may involve certain risks that the Government may wish to consider. In particular, there is a risk that such participation may be understood as an implied guarantee by the Government so that the parties, or even third parties, might expect the Government to back the project fully or eventually even take it over at its own cost if the project company fails. Where such an implied guarantee is not intended, appropriate provisions should be made to clarify the limits of governmental involvement in the project (e.g. contractual provisions releasing the Government from any obligation to subscribe to additional shares in the event that the project company's capital needs to be increased).

(c) Subsidies

37. Tariff subsidies are used in some countries to supplement the project company's revenue when the actual income of the project falls below a certain minimum level. The provision of the services in some areas where

the project company is required to operate may not be a profitable undertaking, because of low demand or high operational costs, or because the project company is required to provide the service to a certain segment of the population at low cost. Thus, the law in some countries authorizes the Government to undertake to extend subsidies to the project company in order to make it possible to provide the services at a lower price.

38. Subsidies usually take the form of direct payments to the project company, either lump-sum payments or payments calculated specifically to supplement the project company's revenue. In the latter case, the Government should ensure that it has in place adequate mechanisms for verifying the accuracy of subsidy payments made to the project company, by means, for example, of audit and financial disclosure provisions in the project agreement. An alternative to direct subsidies may be to allow the project company to cross-subsidize less profitable activities with revenue earned in more profitable ones. This may be done by combining in the same concession both profitable and less profitable activities or areas of operation, or by granting to the project company the commercial exploitation of a separate and more profitable ancillary activity (see paras. 54-56).

39. However, it is important for the legislature to consider practical implications and possible legal obstacles to the provision of subsidies to the project company. For example, subsidies are found to distort free competition and the competition laws of many countries prohibit the provision of subsidies or other forms of direct financial aid that are not expressly authorized by legislation.

(d) Sovereign guarantees

40. In connection with privately financed infrastructure projects, the term "sovereign guarantees" is sometimes used to refer to two types of guarantee provided by the host Government. The first type includes guarantees issued by the host Government to cover the breach of obligations assumed by the contracting authority under the project agreement. A second category includes guarantees that the project company will not be prevented by the Government from exercising certain rights that are granted to it under the project agreement or that derive from the laws of the country, for example, the right to repatriate profits at the end of the project. Whatever form such guarantees may take, it is important for the Government and the legislature to consider the Government's ability to assess and manage efficiently its own exposure to project risks and to determine the acceptable level of direct or contingent liabilities it can assume.

(i) Guarantees of performance by the contracting authority

41. Performance guarantees may be used where the contracting authority is a separate or autonomous legal entity that does not engage the responsibility of the Government itself. Such guarantees may be issued in the name of the Government or of a public financial institution of the host country. They may also take the form of a guarantee issued by international financial institutions that are backed by a counter-guarantee by the Government (see paras. 57-67). Guarantees given by the Government may be useful instruments to protect the project company from the consequences of default by the contracting authority or other governmental agency assuming specific obligations under the project agreement. The most common situations in which such guarantees are used include the following:

(a) *Off-take guarantees*. Under these arrangements, the Government guarantees payment of goods and services supplied by the project company to public entities. Payment guarantees are often used in connection with payment obligations under "off-take" agreements in the power-generation sector (see chap. IV, "The project agreement", ___). Such guarantees may be of particular importance where the main or sole customer of the project company is a government monopoly. Additional comfort is provided to the project company and lenders when the guarantee is subscribed by an international financial institution (see paras. 61 and 66);

(b) *Supply guarantees.* Supply guarantees may also be provided to protect the project company from the consequences of default by public sector entities providing goods and supplies required for the operation of the facility—fuel, electricity or water, for example—or to secure payment of indemnities for which the contracting entity may become liable under the supply agreement;

(c) *General guarantees.* These are guarantees intended to protect the project company against any form of default by the contracting authority, rather than default on specifically designated obligations. Although general performance guarantees may not be very frequent, there are cases in which the project company and the lenders may regard them as a condition necessary for executing the project. This may be the case, for example, where the obligations undertaken by the contracting authority are not commensurate with its creditworthiness, as may happen in connection with large concessions granted by municipalities or other autonomous entities. Guarantees by the Government may be useful to ensure specific performance, for example, when the host Government undertakes to substitute for the contracting entity in the performance of certain acts (e.g. delivery of an appropriate site for disposal of by-products).

42. Generally, it is important not to overestimate the adequacy of sovereign guarantees alone to protect the project company against the consequences of default by the contracting authority. Except when their purpose is to ensure specific performance, sovereign guarantees usually have a compensatory function. Thus, they may not substitute for appropriate contractual remedies in the event of default by the contracting authority (see chap. IV, "The project agreement", ___). Different types of contractual remedies, or combinations thereof, may be used to deal with various events of default, for example, liquidated damages in the event of default and tariff increases or contract extensions in the event of additional delay in project execution caused by acts of the contracting authority. Furthermore, in order to limit the Government's exposure and to reduce the risk of calls on the guarantee, it is advisable to consider measures to encourage the contracting authority to live up to its obligations under the project agreement or to make efforts to control the causes of default. Such measures may include express subrogation rights of the guarantor against the contracting authority or internal control mechanisms to ensure the accountability of the contracting authority or its agents in the event, for instance, of wanton or reckless breach of its obligations under the project agreement resulting in a call on the sovereign guarantee.

(ii) Guarantees against adverse acts of Government

43. Unlike performance guarantees, which protect the project company against the consequences of default by the contracting authority, the guarantees considered here relate to acts of other authorities of the host country that are detrimental to the rights of the project company or otherwise substantially affect the implementation of the project agreement. Such guarantees are often referred to as "political risk guarantees".

44. One type of guarantee contemplated in national laws consists of foreign exchange guarantees, which usually fulfil three functions: to guarantee the convertibility of the local earnings into foreign currency; to guarantee the availability of the required foreign currency and to guarantee the transferability abroad of the converted sums. However, a foreign exchange guarantee is not normally intended to protect the project company and the lenders against the risks of exchange rate fluctuation or market-induced devaluation, which are considered to be ordinary commercial risks. Foreign exchange guarantees are common in privately financed infrastructure projects involving a substantial amount of debt denominated in currencies other than the local currency, in particular in those countries which do not have freely convertible currencies. Some laws also provide that such a guarantee may be backed by a bank guarantee issued in favour of the project company.

45. Another important type of guarantee may be to assure the company and its shareholders that they will not be expropriated without adequate compensation. Such a guarantee would typically extend both to confiscation of property owned by the project company in the host country and to the nationalization of the project company

itself, that is, confiscation of shares of the project company's capital. This type of guarantee is usually provided for in laws dealing with direct foreign investment and in bilateral investment protection treaties (see chap. VII, "Governing law", ___).

(e) Tax and customs benefits

46. Another method for the host Government to support the execution of privately financed projects could be to grant some form of tax and customs exemption, reduction or benefit. Domestic legislation on foreign direct investment often provides special tax regimes to encourage foreign investment and in some countries it has been found useful expressly to extend such a taxation regime to foreign companies participating in privately financed infrastructure projects (see also chap. VII, "Governing law", __).

47. Typical tax exemptions or benefits include exemption from income or profit tax, or property tax on the facility, or exemptions from income tax on interest due on loans and other financial obligations assumed by the project company. Some laws provide that all transactions related to a privately financed infrastructure project will be exempted from stamp duties or similar charges. In some cases, the law establishes some preferential tax treatment or provides that the project company will benefit from the same favourable tax treatment generally given to foreign investments. Sometimes the tax benefit takes the form of a more favourable income tax rate, combined with a decreasing level of exemption during the initial years of the project. Such exemptions and benefits are sometimes extended to the contractors engaged by the project company, in particular foreign contractors.

48. Further taxation measures sometimes used to promote privately financed infrastructure projects are exemptions from withholding tax to foreign lenders providing loans to the project. Under many legal systems, any interest, commission or fee in connection with a loan or indebtedness that is borne directly or indirectly by locally established companies or is deductible against income earned locally is deemed to be local income for taxation purposes. Therefore, both local and foreign lenders to infrastructure projects may be liable to the payment of income tax in the host country, which the project company may be required to withhold from payments to foreign lenders, as non-residents of the host country. Income tax due by the lenders in the host country is typically taken into account in the negotiations between the project company and the lenders and may result in a higher financial cost for the project. In some countries, the competent organs are authorized to grant exemptions from withholding tax in connection with payments to non-residents that are found to be made for a purpose that promotes or enhances the economic or technological development of the host country or are otherwise deemed to be related to a purpose of public relevance.

49. Special accounting rules for infrastructure operators have also been introduced in some countries to take into account the particular revenue profile of infrastructure projects. Projects involving the construction of infrastructure facilities, in particular roads and other transportation facilities, are typically characterized by a relatively short investment period, with high financial cost and no revenue stream, followed by a longer period with increasing revenue and decreasing financial cost and, under normal circumstances, stable operating costs. Accordingly, if traditional accounting rules were applied, the particular financial structure of such projects would need to be recorded in the project company's accounts as a period of continuous negative results followed by a long period of net profit. This would not only have negative consequences, for instance, for the project company's credit rating during the construction phase, but might also result in a disproportionate tax debt during the operational phase of the project. In order to avoid such a distortion, some countries have adopted special accounting rules for companies undertaking infrastructure projects that take into account the fact that the financial results of privately financed infrastructure projects may only become positive on a medium-term basis. Those special rules typically authorize infrastructure developers to defer part of the financial cost accrued during the deficit phase to the subsequent financial years, in accordance with financial schedules provided in the project

agreement. However, the special accounting rules are typically without prejudice to other rules of law that may prohibit the distribution of dividends during financial years closed with negative results.

50. Besides tax benefits or exemptions, national laws sometimes facilitate the import of equipment for the use of the project company by means of exemption from customs duties. Such exemption typically applies to the payment of import duties on equipment, machinery, accessories, raw materials and materials imported into the country for purposes of conducting preliminary studies, designing, constructing and operating infrastructure projects. In the event that the project company wishes to transfer or sell the imported equipment on the domestic market, the approval of the contracting authority usually needs to be obtained and the relevant import duties, turnover tax or other taxes need to be paid in accordance with the laws of the country. Sometimes the law authorizes the Government either to grant an exemption from customs duty or to guarantee that the level of duty will not be raised to the detriment of the project.

(f) Protection from competition

51. An additional form of governmental support may consist of assurances that no competing infrastructure project will be developed for a certain period or that no agency of the Government will compete with the project company, directly or through another concessionaire. Assurances of this sort serve as a guarantee that the exclusivity rights that may be granted to the concessionaire (see chap. I, "General legislative considerations", ___) will not be nullified during the life of the project. Protection from competition may be regarded by the project company and the lenders as an essential condition for participating in the development of infrastructure in the host country. Some national laws contain provisions whereby the Government undertakes not to facilitate or support the execution of a parallel project that might generate competition to the project company. In some cases, the law contains an undertaking by the Government that it will not alter the terms of such exclusivity to the detriment of the project company without the project company's consent.

52. Provisions of this type may be intended to foster the confidence of the project sponsors and the lenders that the basic assumptions under which the project was awarded will be respected. However, they may limit the ability of the Government to deal with an increase in the demand for the service concerned as the public interest may require or to ensure the availability of the services to various categories of user. It is therefore important to consider carefully the interests of the various parties involved. For instance, the required tariff level to allow profitable exploitation of a tollroad may exceed the paying capacity of low-income segments of the public. Thus, the contracting authority may have an interest in maintaining open to the public a toll-free road as an alternative to a new tollroad. At the same time, however, if the contracting authority decides to improve or upgrade the alternative road, the traffic flow may be diverted from the tollroad built by the project company, thus affecting its flow of income. Similarly, the Government may wish to introduce free competition for the provision of long-distance telephone services in order to expand the availability and reduce the cost of telecommunication services (see "Introduction and background information on privately financed infrastructure projects", ___). The consequence of such a measure, however, may be a significant erosion of the income anticipated by the project company.

53. Generally, it may be useful to authorize the Government, where appropriate, to give assurances that the project company's exclusive rights will not be unduly affected by subsequent changes in governmental policies without appropriate compensation. However, it may not be advisable to adopt statutory provisions that rule out the possibility of subsequent changes in the Government's policy for the sector concerned, including a decision to promote competition or to build parallel infrastructure. The possible consequences of such future changes for the project company should be dealt with by the parties in contractual provisions dealing with changes in circumstances (see chap. V, "Infrastructure development and operation", ___). It is particularly advisable to provide the contracting authority with the necessary power to negotiate with the project company the compensation that may be due for loss or damage that may result from a competing infrastructure project

subsequently launched by the contracting authority or from any equivalent measure of the Government that adversely affects the project company's exclusive rights.

(g) Ancillary revenue sources

54. One additional form of support to the execution of privately financed infrastructure projects may be to allow the project company to diversify its investment through additional concessions for the provision of ancillary services or the exploitation of other activities. In some cases, alternative sources of revenue may also be used as a subsidy to the project company for the purpose of pursuing a policy of low or controlled prices for the main service. Provided that the ancillary activities are sufficiently profitable, they may enhance the financial feasibility of a project: the right to collect tolls on an existing bridge, for example, may be an incentive for the execution of a new toll bridge project. However, the relative importance of ancillary revenue sources should not be overemphasized.

55. In order to allow the project company to pursue ancillary activities, it may be necessary for the Government to receive legislative authorization to grant the project company the right to use property belonging to the contracting authority for the purposes of such activities (e.g. land adjacent to a highway for construction of service areas). Where it is felt necessary to control the development and possibly the expansion of such ancillary activities, the approval of the contracting authority might be required in order for the project company to undertake significant expansion of facilities used for ancillary activities.

56. Under some legal systems, certain types of ancillary source of revenue offered by the Government may be regarded as a concession separate from the main concession and it is therefore advisable to review possible limitations to the project company's freedom to enter into contracts for the operation of ancillary facilities (see chap. IV, "The project agreement", ___).

D. Guarantees provided by international financial institutions

57. Besides guarantees given directly by the host Government, there may be guarantees issued by international financial institutions, such as the World Bank, the Multilateral Investment Guarantee Agency and the regional development banks. Such guarantees usually protect the project company against certain political risks, but under some circumstances they may also cover breach of the project agreement, for instance, where the project company defaults on its loans as a result of the breach of an obligation by the contracting authority.

1. Guarantees issued by multilateral lending institutions

58. In addition to lending to Governments and governmental agencies, multilateral lending institutions, such as the World Bank and the regional development banks, have developed programmes to extend loans to the private sector. Sometimes they can also provide guarantees to commercial lenders for public and private sector projects. In most cases, such guarantees issued by those institutions require a counter-guarantee from the host Government.

59. Guarantees by multilateral lending institutions are designed to mitigate the risks of default on sovereign contractual obligations or long-maturity loans that private lenders are not prepared to bear and are not equipped to evaluate. For instance, guarantees provided by the World Bank may typically cover specified risks (the partial risk guarantee) or all credit risks during a specified part of the financing term (the partial credit guarantee), as summarized below. Most regional development banks provide guarantees under terms similar to those of the World Bank.

(a) Partial risk guarantees

60. A partial risk guarantee covers specified risks arising from non-performance of sovereign contractual obligations or certain political *force majeure* events. Such guarantees ensure payment in the case of debt service default resulting from the non-performance of contractual obligations undertaken by Governments or their agencies. They may cover various types of non-performance, such as failure to maintain the agreed regulatory framework, including tariff formulas; failure to deliver inputs, such as fuel supplied to a private power company; failure to pay for outputs, such as power purchased by a government utility from a power company or bulk water purchased by a local public distribution company; failure to compensate for project delays or interruptions caused by government actions or political events; procedural delays; and adverse changes in exchange control laws or regulations.

61. When multilateral lending institutions participate in financing a project, they sometimes provide support in the form of a waiver of recourse that they would otherwise have to the project company in the event that default is caused by events such as political risks. For example, a multilateral lending institution taking a completion guarantee from the project company may accept that it cannot enforce that guarantee if the reason for failure to complete was a political risk reason.

(b) Partial credit guarantees

62. Partial credit guarantees are provided to private sector borrowers with a government counter-guarantee. They are designed to cover the portion of financing that falls due beyond the normal tenure of loans provided by private lenders. These guarantees are generally used for projects involving private sector participation that need long-term funds to be financially viable. A partial credit guarantee typically extends maturities of loans and covers all events of non-payment for a designated part of the debt service.

2. Guarantees provided by the Multilateral Investment Guarantee Agency

63. The Multilateral Investment Guarantee Agency (MIGA) offers long-term political risk insurance coverage to new investments originating in any member country and destined for any developing member country other than the country from which the investment originates. New investment contributions associated with the expansion, modernization or financial restructuring of existing projects are also eligible, as are acquisitions that involve the privatization of state enterprises. Eligible forms of foreign investment include equity, shareholder loans and loan guarantees issued by equity holders, provided the loans and loan guarantees have terms of at least three years. Loans to unrelated borrowers can also be insured, as long as a shareholder investment in the project is concurrently insured. Other eligible forms of investment are technical assistance, management contracts and franchising and licensing agreements, provided they have terms of at least three years and the remuneration of the investor is tied to the operating results of the project. MIGA insures against the following risks: foreign currency transfer restrictions, expropriation, breach of contract, war and civil disturbance.

(a) Transfer restrictions

64. The purpose of guarantees of foreign currency transfer extended by MIGA is similar to that of sovereign foreign exchange guarantees that may be provided by the host Government (see para. 44). This guarantee protects against losses arising from an investor's inability to convert local currency (capital, interest, principal, profits, royalties and other remittances) into foreign exchange for transfer outside the host country. The coverage insures against excessive delays in acquiring foreign exchange caused by action or failure to act by the host Government, by adverse changes in exchange control laws or regulations and by deterioration in conditions governing the conversion and transfer of local currency. Currency devaluation is not covered. On

receipt of the blocked local currency from an investor, MIGA pays compensation in the currency of its contract of guarantee.

(b) Expropriation

65. This guarantee protects against loss of the insured investment as a result of acts by the host Government that may reduce or eliminate ownership of, control over or rights to the insured investment. In addition to outright nationalization and confiscation, "creeping" expropriation—a series of acts that, over time, have an expropriatory effect—is also covered. Coverage is provided on a limited basis for partial expropriation (e.g. confiscation of funds or tangible assets). Bona fide, non-discriminatory measures taken by the host Government in the exercise of legitimate regulatory authority are not covered. For total expropriation of equity investments, MIGA pays the net book value of the insured investment. For expropriation of funds, MIGA pays the insured portion of the blocked funds. For loans and loan guarantees, the Agency insures the outstanding principal and any accrued and unpaid interest. Compensation is paid upon assignment of the investor's interest in the expropriated investment (e.g. equity shares or interest in a loan agreement) to MIGA.

(c) Breach of contract

66. This guarantee protects against losses arising from the host Government's breach or repudiation of a contract with the investor. In the event of an alleged breach or repudiation, the investor must be able to invoke a dispute resolution mechanism (e.g. arbitration) under the underlying contract and obtain an award for damages. If, after a specified period of time, the investor has not received payment or if the dispute resolution mechanism fails to function because of actions taken by the host Government, MIGA will pay compensation.

(d) War and civil disturbance

67. This guarantee protects against loss from damage to, or the destruction or disappearance of, tangible assets caused by politically motivated acts of war or civil disturbance in the host country, including revolution, insurrection, *coup d'état*, sabotage and terrorism. For equity investments, MIGA will pay the investor's share of the least of the book value of the assets, their replacement cost and the cost of repair of damaged assets. For loans and loan guarantees, MIGA will pay the insured portion of the principal and interest payments in default as a direct result of damage to the assets of the project caused by war and civil disturbance. War and civil disturbance coverage also extends to events that, for a period of one year, result in an interruption of project operations essential to overall financial viability. This type of business interruption is effective when the investment is considered a total loss; at that point, MIGA will pay the book value of the total insured equity investment.

E. Guarantees provided by bilateral institutions

68. Insurance against certain political, commercial and financial risks, as well as direct lending, may be obtained from export credit agencies. Export credit agencies have typically been established in a number of countries to assist in the export of goods or services originating from that country. Export credit agencies act on behalf of the Governments of the countries supplying goods and services for the project. Most export credit agencies are members of the International Union of Credit and Investment Insurers (Berne Union), whose main objectives include promoting international cooperation and fostering a favourable investment climate; developing and maintaining sound principles of export credit insurance; and establishing and sustaining discipline in the terms of credit for international trade.

69. While the support available differs from country to country, export credit agencies typically offer two lines of coverage:

(a) *Export credit insurance*. The essential purpose of export credit insurance is to guarantee payment to the seller whenever a foreign buyer of exported goods or services is allowed to defer payment. Export credit insurance may take the form of "supplier credit" or "buyer credit" insurance arrangements. Under the supplier credit arrangements the exporter and the importer agree on commercial terms that call for deferred payment evidenced by negotiable instruments (e.g. bills of exchange or promissory notes) issued by the buyer. Subject to proof of creditworthiness, the exporter obtains insurance from an export credit agency in his or her home country. Under the buyer credit modality, the buyer's payment obligation is financed by the exporter's bank, who, in turn obtains insurance coverage from an export credit agency. Export credits are generally classified as short-term (repayment terms of usually under two years), medium-term (usually two to five years) and long-term (over five years). Official support by export credit agencies may take the form of "pure cover", by which is meant insurance or guarantees given to exporters or lending institutions without financing support. Official support may also be given in the form of "financing support", which is defined as including direct credits to the overseas buyer, refinancing and all forms of interest rate support;

(b) *Investment insurance*. Export credit agencies may offer insurance coverage either directly to a borrower or to the exporter for certain political and commercial risks. Typical political and commercial risks include war, insurrection or revolution; expropriation, nationalization or requisition of assets; non-conversion of currency; and lack of availability of foreign exchange. Investment insurance provided by export credit agencies typically protects the investors in a project company established overseas against the insured risks, but not the project company itself. Investment insurance cover tends to be extended to a wide range of political risks. Export credit agencies prepared to cover such risks will typically require sufficient information on the legal system of the host country.

70. The conditions under which export credit agencies of countries members of the Organisation for Economic Cooperation and Development (OECD) offer support to both supplier and buyer credit transactions have to be in accordance with the OECD Arrangement on Guidelines for Officially Supported Export Credits (also referred to as the "OECD consensus"). The main purpose of the Arrangement is to provide a suitable institutional framework to prevent unfair competition by means of official support for export credits. In order to avoid market-distorting subsidies, the Arrangement regulates the conditions of terms of insurances, guarantees or direct lending supported by Governments.

Notes

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PRIVATELY FINANCED INFRASTRUCTURE PROJECTS

Draft chapters of a legislative guide on privately financed infrastructure projects

Report of the Secretary-General

Addendum

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LEGISLATIVE RECOMMENDATIONS

General considerations (see paras. 1-30)

(1) The host country may wish to require the use of competitive procedures for the selection of the concessionaire, subject to the adjustments necessary to take into account the particular needs of privately financed infrastructure projects.

Preselection of bidders (see paras. 39-56)

(2) The host country may wish to provide:

(a) That the bidders should demonstrate that they possess the professional and technical qualifications, financial and human resources, equipment and other physical facilities, managerial capability, reliability and experience, as necessary to carry out all the phases of the project and that they meet such other qualification criteria as may be required under the general procurement laws of the host country.

(b) That the bidders may form consortia to submit proposals, provided that their members should not participate, directly or through subsidiary companies, in more than one consortium.

(c) That any margin of preference for national bidders or bidders who offer to procure supplies, services and products in the local market should be applied at the evaluation phase and must be announced in the invitation to the preselection proceedings;

(d) That the contracting authority may consider arrangements for compensating preselected bidders if the project cannot proceed for reasons outside their control or for contributing to the costs incurred by them;

(e) That the contracting authority should elaborate a short list of the preselected bidders which will be subsequently invited to submit proposals upon completion of the preselection phase.

Single-stage and two-stage procedure for requesting proposals (see paras. 58-64)

(3) The host country may wish to provide that, upon completion of the preselection proceedings, the contracting authority should invite the preselected bidders to submit final proposals with price with respect to the technical specifications or performance indicators and contractual terms.

(4) Notwithstanding the above, the host country may wish to provide that the contracting authority may use a two-stage procedure to request proposals from preselected bidders when it is not feasible for the contracting authority to formulate technical specifications or performance indicators

and contractual terms in a manner sufficiently detailed and precise to permit final proposals to be formulated.

(5) Where a two-stage procedure is used, the host country may wish to provide:

(a) That the contracting authority should first call upon the preselected bidders to submit proposals relating to broad output specifications and other characteristics of the project as well as to the envisaged contractual terms;

(b) That the contracting authority may convene a meeting of bidders to clarify questions concerning the initial request for proposals and to engage in discussions with any bidder concerning any aspect of its proposal;

(c) That, following those discussions, the contracting authority may review and, as appropriate, revise the initial specifications prior to issuing a final request for proposals.

Content of the final request for proposals (see paras. 65-74)

(6) The host country may wish to provide that the final request for proposals should include the following information:

(a) General information as may be required by the bidders in order to prepare and submit their proposals;

(b) Technical specifications and performance indicators, as appropriate;

(c) The contractual terms envisaged by the contracting authority;

(d) The criteria for evaluating the proposals, the relative weight to be accorded to each such criterion and the manner in which they are to be applied in the evaluation of proposals.

Clarifications and modifications (see paras. 75-76)

(7) The host country may wish to provide:

(a) That the contracting authority may, whether on its own initiative or as a result of a request for clarification by a bidder, modify the request for proposals by issuing an addendum at any time prior to the deadline for submission of proposals;

(b) That the contracting authority should prepare minutes of any meeting of bidders convened by the contracting authority, which should contain the requests submitted at the meeting for clarification of the request for proposals, and its responses to those requests, without identifying the sources of the requests.

Contents of the final proposals (see paras. 77-82)

(8) The host country may wish to require that final proposals provide the information required in the request for proposals, in such a manner as to allow the contracting authority to consider the operational feasibility, technical soundness and environmental impact of the project; the total project cost, including operating and maintenance cost and proposed financing plan; and the proposed tariff or payment schedule, as appropriate.

Evaluation criteria (see paras. 83-86)

(9) The host country may wish to provide that evaluation criteria for the technical proposals should concern the effectiveness of the proposal submitted by the bidder in meeting the needs of the contracting authority, including the following:

(a) Technical soundness;

(b) Operational feasibility;

(c) Soundness of the proposed financial arrangements;

(d) Compliance with environmental standards;

(10) The host country may wish to provide that the criteria for the evaluation and comparison of the financial proposals may include, as appropriate:

(a) The present value of the proposed tolls, fees, and other charges over the concession period according to the prescribed minimum design and performance standards;

(b) The present value of the proposed schedule of amortization payments for the facility to be constructed;

(c) The costs for design and construction activities; annual operation and maintenance costs; present value of capital costs and operating costs;

(d) The amount of subsidy, if any, expected from the Government.

Submission, opening, comparison and evaluation of proposals (see paras. 87-91)

(11) The host country may wish to provide:

(a) That upon receipt of the final proposals, the contracting authority should ascertain whether they are *prima facie* responsive to the request for proposals and should reject proposals found to be incomplete or partial;

(b) That the contracting authority may establish a threshold with respect to quality and technical aspects to be reflected in the technical proposals in accordance with the technical criteria as set out in the proposals;

(c) That proposals which fail to achieve the threshold with respect to quality and technical aspects should be regarded as non-responsive.

Final negotiations (see paras. 92-93)

(12) The host country may wish to provide:

(a) That the contracting authority should rank all responsive proposals on the basis of the evaluation criteria set forth in the request for proposals and invite for final negotiation of the project agreement the bidder that has submitted the most advantageous proposal;

(b) That the most advantageous proposal should be:

(i) The proposal offering the lowest price among those that have passed the threshold with respect to quality and technical aspects, where the proposed unit price for the output is the deciding factor; or

(ii) The proposal that obtains the highest combined rating in respect of both price and non-price evaluation criteria. However, the awarding committee should provide a written justification of the reasons for selecting a proposal other than the one offering the lowest unit price for the output.

(c) That final negotiations may not concern those terms of the contract that were deemed not negotiable in the final request for proposals.

Notice of project award (see para. 94)

(13) The host country may wish to provide:

(a) That the contracting authority should cause a notice of the award of the project to be published;

(b) That the notice should identify the concessionaire and provide a summary of the essential terms of the project agreement.

Direct negotiations (see paras. 95-100)

(14) The host country may wish to provide that direct negotiations may be resorted to only in exceptional circumstances which may include the following:

(a) When there is an urgent need for ensuring continuity in the provision of the service, and engaging in a competitive selection procedure would therefore be impractical, provided

that the circumstances giving rise to the urgency were neither foreseeable by the contracting authority nor the result of dilatory conduct on its part;

(b) In case of projects of short duration and with an anticipated initial investment value not exceeding a specified low amount;

(c) Reasons of national defence;

(d) Cases where there is only one source capable of providing the required service (e.g. because it requires the use of patented technology or unique know-how);

(e) Lack of experienced personnel or of an adequate administrative structure to conduct competitive selection procedures;

(f) Cases where a higher administrative authority of the host country authorizes such an exception for reasons of public interest.

(15) The host country may wish to provide that direct negotiations might be further resorted to when an invitation to the preselection proceedings or a request for proposals has been issued but no applications or proposals were submitted, or all proposals were rejected by the contracting authority, and when, in the judgement of the contracting authority, issuing a new request for proposals would be unlikely to result in a project award.

Measures to enhance transparency in direct negotiations (see paras. 101-107)

(16) The host country may wish to provide:

(a) That the approval of a higher authority should be obtained in order for the contracting authority to engage in selection through negotiation;

(b) That the contracting authority should publish a notice of the negotiation proceedings and engage in negotiations with as many companies judged susceptible of meeting the need as circumstances permit;

(c) That the contracting authority should establish the criteria for evaluating the proposals and determine the relative weight to be accorded to each such criterion and the manner in which they are to be applied in the evaluation of the proposals;

(d) That the contracting authority should treat proposals in such a manner so as to avoid the disclosure of their contents to competing bidders;

(e) That any such negotiations between the contracting and bidders should be confidential and one party to the negotiations should not reveal to any other person any technical, price or other market information relating to the negotiations without the consent of the other party;

(f) That, following completion of negotiations, the contracting authority should request all bidders remaining in the proceedings to submit, by a specified date, a best and final offer with respect to all aspects of their proposals;

(g) That any award by the contracting authority be made to the bidder whose proposal best meets the needs of the contracting authority as determined in accordance with the criteria for evaluating the proposals set forth in the invitation to negotiate, as well as with the relative weight and manner of application of those criteria indicated in the request for proposals.

Unsolicited proposals (see paras. 108-118)

(17) The host country may wish to provide that, under exceptional circumstances, the contracting authority may be authorized to receive unsolicited proposals, provided that such proposals should not relate to a project for which selection procedures have been initiated or announced by the contracting authority.

Procedures for determining the admissibility of unsolicited proposals (see paras. 122-124)

(18) The host country may wish to provide:

(a) That the contracting authority should request the authors of an unsolicited proposal to submit an initial proposal containing sufficient information to allow the contracting authority to make a *prima facie* assessment of whether the conditions for handling unsolicited proposals are met, in particular whether the proposed project is in the public interest;

(b) That, following a preliminary examination, the contracting authority should inform the company, within a reasonably short period, whether or not there is a potential public interest in the project;

(c) That for projects found to be in the public interest, the contracting authority should invited the proponent to submit a formal proposal in sufficient detail to allow the contracting authority to properly evaluate the concept or technology and determine whether it meets the required conditions and is likely to be successfully implemented at the scale of the proposed project;

(d) That the proponent should retain title to all documents submitted throughout the procedure, and those documents should be returned to it in the event the proposal is rejected.

Procedures for handling unsolicited proposals which do not involve proprietary concepts or technology (see paras. 125-126)

(19) The host country may wish to provide:

(a) That the contracting authority should initiate competitive selection procedures under recommendations 3 to 22 above if it is found that the implementation of the project is possible without the use of a process, design, methodology or engineering concept for which the

proponent or its partners possess exclusive rights or proposed concept or technology is not truly unique or new;

(b) That the company that submitted the original proposal should be invited to participate in such proceedings and might be given a premium for submitting the proposal.

Procedures for handling unsolicited proposals involving proprietary concepts or technology (see paras. 127-128)

(20) The host country may wish to provide:

(a) That the contracting authority should use a procedure for obtaining elements of comparison for the unsolicited proposal if it appears that the innovative aspects of the proposal are such that it would not be possible to implement the project without using a process, design, methodology or engineering concept for which the proponent or its partners possess exclusive rights;

(b) That the contracting authority should publish a summary of the essential terms of the proposal with an invitation for other interested parties to submit alternative or comparable proposals within a certain reasonable period;

(c) That the contracting authority may engage in direct negotiations with the original proponent if no alternative proposals are received, subject to approval by the same authority whose approval would normally be required in order for the contracting authority to select a concessionaire through direct negotiation;

(d) That, if alternative proposals are submitted, the contracting authority should invite all the proponents to competitive negotiations with a view to identifying the most advantageous proposal for carrying out the project.

Review procedures (see paras. 129-133)

(21) The host country may wish to establish procedures whereby bidders who claim to have suffered, or who may suffer, loss or injury due to a breach of a duty imposed on the contracting authority by the law may seek review of the contracting authority's acts.

Record of selection proceedings (see paras. 134-141)

(22) The host country may wish to provide that the contracting authority should keep an appropriate record of key information pertaining to the selection proceedings.

NOTES ON LEGISLATIVE RECOMMENDATIONS

A. General considerations

1. This chapter deals with methods and procedures recommended to be used for the award of privately financed infrastructure projects. In line with the advice of international organizations, such as the World Bank 1/ and UNIDO 2/, the *Guide* expresses a preference for the use of competitive selection procedures, rather than negotiations with bidders, while recognizing that direct negotiations might also be used, according to the legal tradition of the country concerned (see further, paras. 95-98).

2. The selection procedures recommended in this chapter present some of the features of the principal method for the procurement of services under the UNCITRAL Model Law on Procurement of Goods, Construction and Services 3/ with a number of adaptations so as to take into account the particular needs of privately financed infrastructure projects. The method herein consists of a two stage procedure with a preselection phase. It allows some scope for negotiations between the contracting authority and the bidders within clearly defined conditions. The description of the procedures recommended for the selection of the concessionaire is primarily concerned with those elements that are special to, or particularly relevant for, privately financed infrastructure projects. Where appropriate, this chapter refers the reader to provisions of the UNCITRAL Model Law, which may *mutatis mutandis* supplement the selection procedure described herein.

1. Selection procedures covered by the *Guide*

3. Private investment in infrastructure may take various forms, each requiring special methods for selecting the concessionaire. For the purpose of discussing possible selection methods for the infrastructure projects dealt with in the *Guide*, a distinction may be made between three main forms of private investment in infrastructure:

(a) *Purchase of public utilities enterprises*. Private capital may be invested in public infrastructure through the purchase of physical assets or the shares of public utility enterprises. Those transactions are often carried out in accordance with rules governing the award of contracts

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1/ International Bank for Reconstruction and Development, *Procurement under IBRD and IDA Loans*, 1996, para. 3.13(a).

2/ *UNIDO BOT Guidelines*, p. 96.

3/ The UNCITRAL Model Law on Procurement of Goods, Construction and Services (hereafter referred to as "the UNCITRAL Model Law") and its accompanying Guide to Enactment were adopted by the Commission at its twenty-seventh session (New York, 31 May-17 June 1994).

for the disposition of State property. In many countries, the sale of shares of public utility enterprises requires prior legislative authorization. Disposition methods often include offering of shares on stock markets or competitive proceedings such as auctions or invitations to bid whereby the property is awarded to the qualified party offering the highest price;

(b) *Provision of public services without development of infrastructure*. In other types of projects, the service providers own and operate all the equipment necessary and sometimes compete with other suppliers for the provision of the relevant service. Some national laws establish special procedures whereby the State may authorize a private entity to supply public services by means of exclusive or non-exclusive "licences". Licences may be publicly offered to interested parties who satisfy the qualification requirements set forth by the law or established by the licensing authority. Sometimes licensing procedures involve public auctions to interested qualified parties;

(c) *Construction and operation of public infrastructure*. In projects for the construction and operation of public infrastructure, a private entity is engaged to provide both works and services to the public. The procedures governing the award of those contracts are in some aspects similar to those that govern public procurement of construction and services. National laws provide a variety of methods for public procurement, ranging from structured competitive methods, such as tendering proceedings, to less structured negotiations with prospective suppliers.

4. This chapter deals primarily with selection procedures suitable to be used for infrastructure projects which involve an obligation, on the part of the selected private entity, to undertake physical construction, repair, or expansion works in the infrastructure concerned with a view to subsequent private operation (i.e. those referred to in paragraph 3(c)). It does not deal specifically with methods for disposal of State property for privatization purposes or procedures for licensing public service providers.

5. It should be noted, however, that some infrastructure projects may involve elements of more than one of the categories mentioned above. For instance, the acquisition of a privatized public utility (e.g. a water distribution company) may be coupled with an obligation to effect substantial investment in new infrastructure (e.g. expansion of pipe network). In those situations, it is important to ascertain what is the predominant element of the project (e.g. privatization or construction of new infrastructure) in order to choose the appropriate selection procedure which may then be adjusted so as to take into account the main ancillary obligations expected to be assumed by the concessionaire. To that end, some of the considerations set forth in this chapter may also be relevant, *mutatis mutandis*, for the disposal of State property or licensing procedures which involve an obligation on the part of the new concessionaire or licensee to undertake infrastructure works.

2. General objectives of selection procedures

6. For the award of contracts for infrastructure projects, the contracting authority may either apply methods and procedures already provided in the laws of the host country or establish procedures specifically designed for that purpose. In either situation, it is important to ensure that

such procedures are generally conducive to attaining the fundamental objectives of rules governing the award of public contracts. Those objectives are briefly discussed below.

(a) Economy and efficiency

7. In connection with infrastructure projects, economy refers to the selection of a concessionaire that is capable of performing works and delivering services of the desired quality at the most advantageous price and upon the most advantageous contractual terms. It is promoted by procedures that provide a favourable climate for participation in the selection process by competent companies and that provide incentives to them to offer their most advantageous terms.

8. In most cases, economy is best achieved by means of procedures that promote competition among bidders. Competition provides them with incentives to offer their most advantageous terms, and it can encourage them to adopt efficient or innovative technologies or production methods in order to do so. It should be noted, however, that competition does not necessarily require the participation of a large number of bidders in a given selection process. Particularly for large projects, there may be reasons for the contracting authority to wish to limit the number of bidders to a manageable number (see paras. 23-24). Provided that appropriate procedures are in place, the contracting authority can take advantage of effective competition even where the competitive base is limited.

9. Furthermore, economy can often be promoted through participation by foreign companies in selection proceedings. Not only can foreign participation expand the competitive base, it can also lead to the acquisition by the contracting authority and its country of technologies that are not available locally. Foreign participation in selection proceedings may be necessary where there exists no domestic expertise of the type required by the contracting authority. A country desiring to achieve the benefits of foreign participation should ensure that the relevant laws and procedures are conducive to such participation.

10. Efficiency refers to selection of a concessionaire within a reasonable amount of time, with minimal administrative burdens and at reasonable cost both to the contracting authority and to participating bidders. In addition to the losses that can accrue directly to the contracting authority from inefficient selection procedures (e.g. due to delayed selection or high administrative costs), excessively costly and burdensome procedures can lead to increases in the overall project costs or even discourage competent companies from participating altogether in the selection proceedings.

(b) Promotion of integrity of, and confidence in, the selection process

11. Another important objective of rules governing the selection of the concessionaire is to promote the integrity of, and confidence in, the process. Thus, an adequate selection system will usually contain provisions designed to ensure fair treatment of bidders, to reduce or discourage unintentional or intentional abuses of the selection process by persons administering it or by companies participating in it, and to ensure that selection decisions are taken on a proper basis.

12. Promoting the integrity of the selection process will help to promote public confidence in the process and in the public sector in general. Bidders will often refrain from spending the time and sometimes substantial sums of money to participate in selection proceedings unless they are confident that they will be treated fairly and that their proposals or offers have a reasonable chance of being accepted. Those that do participate in selection proceedings in which they do not have that confidence have a tendency to increase the project cost to cover the higher risks and costs of participation. Ensuring that selection proceedings are run on a proper basis could reduce or eliminate that tendency and result in more favourable terms to the contracting authority.

13. The host country should have in place generally an effective system of sanctions including of a criminal nature against corruption by Government officials, including employees of the awarding authorities, and by bidders, which would apply also to the selection process. Conflicts of interest should also be avoided, for instance by requiring that officials of the contracting authority, their spouses, relatives and associates abstain from owning a debt or equity interest in a company participating in a selection process or accepting to serve as a director or employee of such a company. Furthermore, the law governing the selection proceedings should obligate the contracting authority to reject offers or proposals submitted by a party who gives or agrees to give, directly or indirectly, to any current or former officer or employee of the contracting authority or other governmental authority a gratuity in any form, an offer of employment or any other thing or service of value, as an inducement with respect to an act or decision of, or procedure followed by, the contracting authority in connection with the selection proceedings. These provisions may be supplemented by other measures, such as the requirement that all companies invited to participate in the selection process undertake neither to seek to influence unduly the decisions of the public officials involved in the selection process nor otherwise to distort the competition by means of collusive or other illicit practices (e.g. the so-called "integrity agreement"). Also, in the procurement practices adopted by some countries, bidders are required to guarantee that no official of the procuring entity has been or shall be admitted by the bidder to any direct or indirect benefit arising from the contract or the award thereof. Breach of such a provision typically constitutes a breach of an essential term of the contract.

14. An important corollary of the objectives of economy, efficiency, integrity and transparency is the availability of administrative and judicial procedures for the review of decisions made by the authorities involved in the selection proceedings (see paras. 129-133).

15. The confidence of investors may be further fostered by adequate provisions to protect the confidentiality of proprietary information submitted by them during the selection proceedings. This should include sufficient assurances that the contracting authority will treat proposals in such a manner as to avoid the disclosure of their contents to competing bidders; that any discussions or negotiations will be confidential; and that trade or other information that bidders might include in their proposals will not be made known to their competitors.

(c) Transparency of laws and procedures

16. Transparency of laws and procedures governing the selection of the concessionaire will help to achieve various of the policy objectives already mentioned. Transparent laws are those in which the rules and procedures to be followed by the contracting authority and by bidders are

fully disclosed, are not unduly complex, and are presented in a systematic and understandable way. Transparent procedures are those which enable the bidders to ascertain what procedures have been followed by the contracting authority and the basis of decisions taken by it.

17. One of the most important ways to promote transparency and accountability is to include provisions requiring that the contracting authority maintain a record of the selection proceedings (see paras. 134-141). A record summarizing key information concerning those proceedings facilitates the exercise of the right of aggrieved bidders to seek review. That in turn will help to ensure that the rules governing the selection proceedings are, to the extent possible, self-policing and self-enforcing. Furthermore, adequate record requirements in the law will facilitate the work of Government bodies exercising an audit or control function and promote the accountability of awarding authorities to the public at large as regards the award of infrastructure projects.

18. Transparent laws and procedures create predictability, enabling bidders to calculate the costs and risks of their participation in selection proceedings and thus to offer their most advantageous terms. They also help to guard against arbitrary or improper actions or decisions by the contracting authority or its officials and thus help to promote confidence in the process. Transparency of laws and procedures is of particular importance where foreign participation is sought, since foreign companies may be unfamiliar with the country's practices for the award of infrastructure projects.

3. Special features of selection procedures for privately financed infrastructure projects

19. Generally, economy in the award of public contracts is best achieved through methods that promote competition among a range of bidders within structured, formal procedures. Competitive selection procedures, such as tendering, are usually prescribed by national laws as the rule for normal circumstances in procurement of goods or construction.

20. In competitive selection procedures, the contracting authority typically invites a range of companies to submit proposals which must be formulated on the basis of technical specifications and contractual terms specified by the contracting authority in the documents made available by it to bidders. Proposals are examined, evaluated and compared and the decision on which proposal to accept is made in accordance with essentially objective criteria and procedures that are set forth in the procurement laws and in the tender documents. Competitive selection procedures are said to be "open" when the contracting authority solicits proposals by means of a widely advertised invitation to tender directed to all companies wishing to participate in the proceedings. The procedures are said to be "restricted" when the contracting authority solicits proposals only from certain companies selected by it.

21. The formal procedures and the objectivity and predictability that characterize the competitive selection procedures generally provide optimal conditions for competition, transparency and efficiency. Thus, the use of competitive selection procedures in privately financed infrastructure projects has been recommended by UNIDO, which has formulated detailed practical guidance on how to structure those procedures. 4/ The rules for procurement under

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4/ *UNIDO BOT Guidelines*, p. 96.

loans provided by the World Bank also advocate the use of competitive selection procedures and provide that a concessionaire selected pursuant to bidding procedures acceptable to the World Bank is generally free to adopt its own procedures for the award of contracts required to implement the project. However, where the concessionaire was not itself selected pursuant to those competitive procedures, the award of subcontracts has to be done pursuant to competitive procedures acceptable to the World Bank. 5/

22. It should be noted, however, that no international legislative model has thus far been specifically devised for competitive selection procedures in privately financed infrastructure projects. On the other hand, domestic laws on competitive procedures for the procurement of goods, construction or services may not be entirely suitable for privately financed infrastructure projects. International experience in the award of privately financed infrastructure projects has in fact revealed some limitations of traditional forms of competitive selection procedures, such as the tendering method. In the light of the particular issues raised by privately financed infrastructure projects, which are briefly discussed below, it is advisable for the Government to consider adapting such procedures for the selection of the concessionaire.

(a) Range of bidders to be invited

23. In traditional Government procurement, the objective of economy is often maximized by allowing for as wide as possible competition among bidders. Invitations to tender are sometimes issued directly without prior preselection proceedings. Where preselection is required, it is sometimes limited to verifying a number of formal requirements (e.g. the bidders' professional qualification or legal capacity).

24. The award of privately financed infrastructure projects, in turn, typically involves complex, time-consuming and expensive proceedings. Furthermore, the sheer scale of most infrastructure projects reduces the likelihood of obtaining proposals from a large number of suitably qualified bidders. In addition, competent bidders may be reluctant to participate in procurement proceedings for high-value projects if the competitive field is too large and where they run the risk of having to compete with unrealistic proposals or proposals submitted by unqualified bidders. Therefore, open tendering without a preselection phase is usually not advisable for the award of infrastructure projects.

(b) Definition of project requirements

25. In traditional public procurement of construction works the Government usually assumes the position of a *maître d'ouvrage* or employer, while the selected contractor carries out the function of the performer of the works. The procurement procedures emphasize the inputs to be provided by the contractor, i. e. the contracting authority establishes clearly what is to be built, how and by what means. Therefore it is common that invitations to tender for construction works are accompanied by extensive and very detailed technical specifications of the type of works and services being procured. In those cases, the contracting authority will be responsible for ensuring

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5/ International Bank for Reconstruction and Development, *Procurement under IBRD and IDA Loans*, 1996, para. 3.13(a).

that the specifications are adequate to the type of infrastructure to be built and that such infrastructure will be capable of being operated efficiently. In some privately financed infrastructure projects, the contracting authority may wish to establish precise specifications for the works to be performed or the technical means for the services to be provided (i. e. the "input" expected from the concessionaire). Such a choice is made, in particular, in connection with projects involving the construction of new infrastructure to be permanently owned by the Government and destined to be generally open for public use (e.g. roads, tunnels, bridges). In these cases, the contracting authority may see a need to have a larger degree of control over the engineering design and technical specifications than in the case of privately owned facilities generally closed to the public and accessible only to the concessionaire (e.g. a private power plant).

26. However, for many privately financed infrastructure projects, the contracting authority may envisage a different allocation of responsibilities between the public and the private sector. One of the underlying reasons for promoting private sector participation in infrastructure development may be to release the contracting authority from the immediate responsibility for those functions that are capable of being efficiently carried out by the private sector. In those cases, after having established a particular infrastructure need, the contracting authority may prefer to leave to the private sector the responsibility for proposing the best solution for meeting such a need, subject to certain requirements that may be established by the contracting authority (e.g. regulatory performance or safety requirements, sufficient evidence that the technical solutions proposed had been previously tested and satisfactorily met internationally acceptable safety and other standards). The selection procedure used by the contracting authority may thus give more emphasis to the output expected from the project (i.e. the services or goods to be provided) rather than to technical details of the works to be performed or means to be used to provide those services. While the Government remains ultimately accountable to the public for the quality of the works and services, the private sector will bear the risks that might result, for instance, from the inadequacy of the technical solutions used.

(c) Evaluation criteria

27. Goods, construction works or services are typically purchased by Governments with funds available under approved budgetary allocations. With the funding sources usually secured, the main objective of the procuring entity is to obtain the best value for the funds it spends. Therefore, in those types of procurement the decisive factor in establishing the winner among the responsive and technically acceptable proposals is often the global price offered for the construction works, which is calculated on the basis of the cost of the works and other costs incurred by the contractor plus a certain margin of profit.

28. Privately financed infrastructure projects, in turn, are typically expected to be financially self-sustainable, with the development and operational costs being recovered from the project's own revenue. This and the large scale of most infrastructure projects render the task of evaluating proposals considerably more complex than in more traditional forms of procurement. Therefore, a number of other factors will need to be considered in addition to the construction and operation cost and the price to be paid by the users. For instance, the contracting authority will need to consider carefully the financial and commercial feasibility of the project, the soundness of the

financial arrangements proposed by the bidders and the reliability of the technical solutions used. Such interest exists even where no governmental guarantees or payments are involved, because unfinished projects or projects with large cost overruns or higher than expected maintenance costs often have a negative impact on the overall availability of needed services and on the public opinion in the host country. Also, the contracting authority will aim at formulating qualification and evaluation criteria that give adequate weight to the need to ensure the continuous provision of, and, as appropriate, universal access to, the public service concerned. Furthermore, given the usually long duration of infrastructure concessions, the contracting authority will need to satisfy itself of the soundness and acceptability of the arrangements proposed for the operational phase and will weigh carefully the service elements of the proposals (see paras. 83-86).

(d) Negotiations with bidders

29. Laws and regulations governing tendering proceedings often prohibit negotiations between the contracting authority and the contractors concerning a proposal submitted by them. The rationale for such a strict prohibition, which is also contained in article 35 of the UNCITRAL Model Law, is that negotiations might result in an "auction", in which a proposal offered by one contractor is used to apply pressure on another contractor to offer a lower price or an otherwise more favourable proposal. As a result of that strict prohibition, contractors selected to provide goods or services pursuant to traditional procurement procedures are typically required to sign standard contract documents provided to them during the procurement proceedings.

30. The situation is different in the award of privately financed infrastructure projects. The complexity and long duration of those projects makes it unlikely that the contracting authority and the selected bidder could agree on the terms of a draft project agreement without negotiation and adjustments to adapt those terms to the particular needs of the project. This is particularly true for projects involving the development of new infrastructure where the final negotiation of the financial and security arrangements takes place only after the selection of the concessionaire. It is important, however, to ensure that these negotiations are carried out in a transparent manner and do not lead to changes to the basis on which the competition was carried out (see paras. 92-93).

4. Preparations for selection proceedings

31. The award of privately financed infrastructure projects is in most cases a complex exercise requiring careful planning and coordination among the offices involved. By ensuring that adequate administrative and personnel support is available to conduct the type of selection proceeding that it has chosen, the Government plays an essential role in promoting confidence in the selection process.

(a) Appointment of the award committee

32. One important preparatory measure is the appointment of the committee that will be responsible for evaluating the proposals and making an award recommendation to the contracting authority. The appointment of qualified and impartial members to the selection committee is not

only a requirement for an efficient evaluation of the proposals, but may further foster the confidence of bidders in the selection process.

33. Another important preparatory measure is the appointment of the independent advisers who will assist the contracting authority in the selection procedures. The contracting authority may need, at this early stage, to retain the services of independent experts or advisers to assist in establishing appropriate qualification and evaluation criteria, defining performance indicators (and, if necessary, technical specifications) and preparing the documentation to be issued to bidders. Consultant services and advisers may also be retained to assist the contracting authority in the evaluation of proposals, drafting and negotiation of the project agreement in closing the final deal. Consultants and advisers can be particularly helpful by bringing a range of technical expertise which may not always be available in the host country's civil service, such as technical or engineering advice (e.g. on technical assessment of the project or installations, technical requirements of contract); environmental advice (e.g. on environmental assessment, operation requirements); or financial advice (e.g. on financial projections, review of financing sources, assessing the adequate ratio between debt and equity, drafting of financial information documents).

(b) Feasibility and other studies

34. As already indicated (see "Introduction and background information on privately financed infrastructure projects", para. ___), one of the initial steps taken by the Government in respect of a proposed infrastructure project is to conduct a preliminary assessment of its feasibility, including economic and financial aspects such as expected economic advantages of the project, estimated cost and potential revenue anticipated from the operation of the infrastructure facility. The option to develop infrastructure as a privately financed project requires a positive conclusion on the feasibility and financial viability of the project. An assessment of the project's environmental impact should also be ordinarily carried out by the contracting authority as part of its feasibility studies. In some countries, it was found useful to provide for some public participation in the preliminary assessment of the project's environmental impact and the various options available to minimize it.

35. Prior to starting the proceedings leading to the selection of a prospective concessionaire, it is advisable for the contracting authority to review and, as required, expand those initial studies. In some countries awarding authorities are advised to formulate model projects for reference purposes (typically including a combination of estimated capital investment, operation and maintenance costs) prior to inviting proposals from the private sector. The purpose of such model projects is to demonstrate the viability of the commercial operation of the infrastructure and the affordability of the project in terms of total investment cost and cost to the public. They will also provide the contracting authority with a useful tool for comparison and evaluation of proposals. Confidence of bidders will be promoted by evidence that the technical, economical and financial assumptions of the project, as well as the proposed role of the private sector, have been carefully considered by the contracting authority.

(c) Preparation of documentation

36. Selection proceedings for the award of privately financed infrastructure projects typically require the preparation of extensive documentation including a project outline, preselection documents, the request for proposals, instructions for preparing proposals and a draft of the project agreement. The quality and clarity of the documents issued by the contracting authority plays a significant role in ensuring an efficient and transparent selection procedure.

37. In many countries it is customary for the Government to devise standard contract forms and general conditions of contract that are used in public contracting. In some countries there may be fairly detailed standard contracts for different infrastructure sectors. Standard documentation prepared in sufficiently precise terms may be an important element to facilitate the negotiations between bidders and prospective lenders and investors. It may also be useful for ensuring consistency in the treatment of issues common to most projects in a given sector.

38. However, in using standard contract terms it is advisable to bear in mind the possibility that a specific project may raise issues that had not been anticipated when the standard document was prepared or that the project may necessitate particular solutions that might be at variance with the standard terms. Where standard contract documents are provided to bidders during the selection proceedings, the contracting authority may have limited discretion to negotiate the terms of the project agreement with the selected bidders. Careful consideration should be given to the need for achieving the appropriate balance between the level of uniformity desired for project agreements of a particular type and the flexibility that might be needed for finding project-specific solutions.

B. Preselection of bidders

39. Given the complexity of privately financed infrastructure projects the contracting authority may wish to limit the number of bidders from whom proposals will be subsequently requested only to those who satisfy certain qualification criteria. In traditional Government procurement, preselection proceedings may consist of the verification of certain formal requirements, such as adequate proof of technical capability or prior experience in the type of procurement, so that all bidders who meet the preselection criteria are automatically admitted to the tendering phase. Preselection proceedings for privately financed infrastructure projects, in turn, may involve elements of evaluation and selection. Thus, they do not show the same level of automaticity that characterizes the preselection proceedings usually applied for the procurement of goods or services. This may be the case, for example, where the contracting authority establishes a ranking of preselected bidders (see para. 55).

1. Invitation to the preselection proceedings

40. In order to promote transparency and competition, it is advisable that the invitation to the preselection proceedings be published in a manner that reaches an audience wide enough to provide an effective level of competition. The laws of many countries identify publications, usually the official gazette or other official publication, in which the invitation to the preselection proceedings is to be published. With a view to fostering participation of foreign companies and

maximizing competition, the contracting authority may wish to cause the invitations to the preselection proceedings to be published also in a language customarily used in international trade, in a newspaper of wide international circulation or in a relevant trade publication or technical or professional journal of wide international circulation.

41. Preselection documents should contain sufficient information for bidders to be able to ascertain whether the works and services entailed by the project are of a type that they can provide and, if so, how they can participate in the selection proceedings. The invitation to the preselection proceedings should, in addition to identifying the infrastructure to be built or renovated, contain information on other essential elements of the project, such as the services to be delivered by the concessionaire, the financial arrangements envisaged by the contracting authority (e.g. whether the project will be entirely financed by user fees or tolls or whether public funds may be provided as direct payments, loans or guarantees) and, where already known, a summary of the main required terms of the project agreement to be entered into as a result of the selection proceedings.

42. In addition to that, the invitation to the preselection proceedings should include general information similar to the information typically provided in preselection documents under general rules on public procurement (such as, for example, instructions for preparing and submitting preselection applications; any documentary evidence or other information that must be submitted by bidders to demonstrate their qualifications; the manner, place and deadline for the submission of applications).

2. Preselection criteria

43. Generally, bidders should be required to demonstrate that they possess the professional and technical qualifications, financial and human resources, equipment and other physical facilities, managerial capability, reliability and experience, as necessary to carry out the project. Additional criteria that might be particularly relevant for privately financed infrastructure projects may include the ability to manage the financial aspects of the project and previous experience in operating public infrastructure or in providing services under regulatory oversight. Qualification requirements should cover all phases of an infrastructure project, including financing management, engineering, construction, operation and maintenance, where appropriate. In addition to that, the bidders should be required to demonstrate that they meet such other qualification criteria as would typically apply under the general procurement laws of the host country (e.g. that they have legal capacity to enter into the project agreement; that they are not insolvent, in receivership, bankrupt or being wound up, their affairs are not being administered by a court or a judicial officer, their business activities have not been suspended, and they are not the subject of legal proceedings for any of the foregoing; that they have fulfilled their obligations to pay taxes and social security contributions in the State; that they have not, and their directors or officers have not, been convicted of any criminal offence related to their professional conduct or the making of false statements or misrepresentations as to their qualifications to enter into a procurement contract within a certain period of years preceding the commencement of the selection proceedings, or have not been otherwise disqualified pursuant to administrative suspension or disbarment proceedings).

44. The contracting authority should determine the type of information to be provided by the bidders to substantiate their qualification, including, for instance, quality indicators of their past performance as public service providers or infrastructure operators. Such information may relate to the size and type of previous projects carried out by the bidders; the level of experience of the key personnel to be engaged in the project; sufficient organizational capability, including minimum levels of construction, operation and maintenance equipment. The contracting authority should set forth in some detail the manner in which the bidders have to demonstrate their capability to sustain the financing requirements for the engineering, construction and operational phases of the project. The contracting authority may request sufficient information showing the bidders' ability to provide an adequate amount of equity to the project, and sufficient evidence from reputable banks attesting the bidder's good financial standing, and that they have adequate resources.

45. One important aspect to be considered by the contracting authority relates to the relationship between the award of one particular project and the governmental policy pursued for the sector concerned (see "Introduction and background information on privately financed infrastructure projects", paras.___). Where competition is sought, the Government may be interested in ensuring that the relevant market or sector is not dominated by one enterprise (e.g. that the same company does not operate more than a certain limited number of local telephone companies within a given territory). The contracting authority may thus wish to retain the possibility of rejecting a particular proposal if it determines that the award of the project to that particular bidder might give rise to undesirable market domination by a particular company or would otherwise distort competition in the sector concerned. For purposes of transparency, it is desirable for the law to provide that, where the contracting authority reserves the right to reject a proposal on those or similar grounds, adequate notice of that circumstance must be included in the invitation to the preselection proceedings.

46. Qualification requirements should apply equally to all bidders. A contracting authority should not impose any criterion, requirement or procedure with respect to the qualifications of bidders which has not been set forth in the preselection documents. When considering the professional and technical qualifications of bidding consortia, the contracting authority should consider the individual specialization of the consortium members and assess whether the combined qualifications of the consortium members are adequate to meet the needs of all phases of the project.

3. Issues relating to the participation of bidding consortia

47. Given the large scale of most infrastructure projects, the interested companies typically participate in the selection proceedings through consortia especially formed for that purpose. Therefore, information required from members of bidding consortia should relate to the consortium as a whole as well as to its individual participants. For the purpose of facilitating the liaison with the contracting authority, it may be useful to require in the preselection documents that each consortium should designate one of its members as a focal point for all communications with the contracting authority. It is generally advisable for the contracting authority to require that the members of bidding consortia submit a sworn statement undertaking that, if awarded the contract, they shall bind themselves jointly and severally for the obligations assumed in the name

of the consortium under the project agreement. Alternatively, the contracting authority may reserve itself the right to require at a later stage that the members of the selected consortium should establish an independent legal entity to carry out the project (see further chapter IV, "The project agreement", paras. ___).

48. It is further advisable for the contracting authority to review carefully the composition of consortia and their parent companies. It may happen that one company, directly or through subsidiary companies, joins more than one consortium to submit proposals for the same project. Such a situation should not be allowed, since it raises the risk of leakage of information or collusion between competing consortia, thus undermining the credibility of the selection proceedings. It is therefore advisable to provide in the invitation to the preselection proceedings that no company may participate, either directly or through subsidiary companies, in more than one consortium in the same selection proceedings. A violation of this rule should cause the disqualification of the consortia concerned.

4. Preselection and domestic preferences

49. The laws of some countries provide for some sort of preferential treatment for domestic entities or afford special treatment to bidders that undertake to use national goods or employ local labour. Such preferential or special treatment is sometimes provided as a material qualification requirement (e.g. a minimum percentage of national participation in the consortium) or as a condition for participating in the selection procedure (e.g. to appoint a local partner as a leader of the bidding consortium).

50. Domestic preferences may give rise to a variety of issues. Firstly, their use is not permitted under the guidelines of some international financial institutions and might be inconsistent with international obligations entered into by many States pursuant to agreements on regional economic integration or trade facilitation. Furthermore, from the perspective of the host country it is further important to weigh the expected advantages against the disadvantage of depriving the contracting authority of the possibility of obtaining better options to meet the national infrastructure needs. It is also important not to allow total insulation from foreign competition so as not to perpetuate lower levels of economy, efficiency and competitiveness of the concerned sectors of national industry. This is the reason why many countries that wish to provide some incentive to national suppliers, while at the same time taking advantage of international competition, do not contemplate a blanket exclusion of foreign participation or restrictive qualification requirements. Domestic preferences may take the form of special evaluation criteria establishing margins of preference for national bidders or bidders who offer to procure supplies, services and products in the local market. The margin of preference technique, which is provided in article 34(4)(d) of the UNCITRAL Model Law, is more transparent than subjective qualification or evaluation criteria. Furthermore, it allows the contracting authority to favour local bidders that are capable of approaching internationally competitive standards, and it does so without simply excluding foreign competition. Where domestic preferences are envisaged, it is advisable that they be announced in advance, preferably in the invitation to the preselection proceedings.

5. Contribution towards costs of participation in selection proceedings

51. In some countries, a high price may be charged for the preselection documents, while in other countries that price might reflect only the cost of printing the preselection documents and providing them to the bidders. Expensive preselection documents may be used as an additional tool to limit the number of bidders. At the same time, however, they add to the already considerable cost of participation in the selection proceedings. The high costs of preparing proposals for infrastructure projects and the relatively high risks that a selection procedure may not lead to a contract award may function as a deterrent for some companies to join in a consortium to submit a proposal, particularly when they are not familiar with the selection procedures applied in the host country.

52. Therefore, some countries authorize the contracting authority to consider arrangements for compensating preselected bidders if the project cannot proceed for reasons outside their control or for contributing to the costs incurred by them after the preselection phase, when justified in a particular case by the complexity involved and the prospect of significantly improving the quality of the competition. It is advisable that such contribution or compensation, when authorized, be announced at an early stage, preferably in the invitation to the preselection proceedings.

6. Preselection proceedings

53. The contracting authority should respond to any request by a bidding consortium for clarification of the preselection documents that is received by the contracting authority within a reasonable time prior to the deadline for the submission of applications. The response by the contracting authority should be given within a reasonable time so as to enable the bidders to make a timely submission of their application. The response to any request that might reasonably be expected to be of interest to other bidders should, without identifying the source of the request, be communicated to all bidders to which the contracting authority provided the preselection documents.

54. In some countries, practical guidance on selection procedures encourages domestic contracting authorities to limit the prospective proposals to the lowest possible number sufficient to ensure meaningful competition (e.g. three or four). For that purpose, those countries apply a quantitative rating system for technical, managerial and financial criteria, taking into account the nature the project. Quantitative preselection criteria are found to be more easily applicable and transparent than qualitative criteria involving the use of merit points. However, in devising a quantitative rating system, it is important to avoid unnecessary limitation of the contracting authority's discretion in assessing the qualifications of bidders. The contracting authority may also need to take into account the fact that the procurement guidelines of some multilateral financial institutions prohibit the use of preselection proceedings for the purpose of limiting the number of bidders to a predetermined number. In any event, where such a rating system is to be used, that circumstance should be clearly stated in the preselection documents.

55. Upon completion of the preselection phase, the contracting authority usually elaborates a short list of the preselected bidders which will be subsequently invited to submit proposals. One practical problem sometimes faced by awarding authorities concerns proposals for changes in the

composition of bidding consortia during the selection proceedings. From the perspective of the contracting authority, it is generally advisable to exercise caution in respect of proposed substitutions of individual members of bidding consortia after the closing of the preselection phase. Changes in the composition of consortia may substantially alter the basis on which the preselected bidding consortia were short-listed by the contracting authority and may give rise to questions about the integrity of the selection proceedings. As a general rule, only preselected bidders should be allowed to participate in the selection phase, unless the contracting authority can satisfy itself that a new consortium member meets the preselection criteria to substantially the same extent as the retiring member of the consortium.

56. While the criteria used for preselecting bidders should not be weighted again at the evaluation phase, the contracting authority may wish to reserve itself the right to require, at any stage of the selection process, that the bidders again demonstrate their qualifications in accordance with the same criteria used to preselect them.

C. Procedures for requesting proposals

57. This section discusses the procedures for requesting proposals from the preselected bidders. The procedures described herein are in a number of respects similar to the procedures for the solicitation of proposals under the preferred method for the procurement of services provided in the UNCITRAL Model Law, with some adaptations needed to fit the needs of contracting authorities awarding infrastructure projects.

1. Phases of the procedure

58. Following the preselection of bidders, it is advisable for the contracting authority to review its original feasibility study and the definition of the output and performance requirements and consider whether a revision of those requirements is needed in the light of the information obtained during the preselection proceedings. At this stage, the contracting authority should have already determined whether a single or a two-stage procedure will be used to request proposals; whether bidders will be asked to formulate proposals on the basis of performance indicators or technical specifications; and, in the latter case, whether alternatives to those specifications will be considered.

(a) Single-stage procedure

59. The decision between having a single or a two-stage procedure for requesting proposals will depend on the nature of the contract, on how precisely the technical requirements can be defined, and whether output results (or performance indicators) are used for selection of the concessionaire. If it is deemed both feasible and desirable for the contracting authority to formulate performance indicators or technical specifications to the necessary degree of precision or finality, the selection process may be structured as a single-stage procedure, in which case, after having concluded the preselection of bidders, the contracting authority would proceed directly to issue a final request for proposals (see paras. 65-74)

(b) Two-stage procedure

60. There are cases, however, in which it may not be feasible for the contracting authority to formulate its requirement in sufficiently detailed and precise technical specifications or performance indicators to permit proposals to be formulated, evaluated and compared uniformly on the basis of those specifications and indicators. This may be the case, for instance, when the contracting authority has not determined the type of technical and material input that would be suitable for the project in question (e.g. the type of construction material to be used in a bridge). In such cases, it might be considered undesirable, from the standpoint of obtaining the best value, for the contracting authority to proceed on the basis of specifications or indicators it has drawn up in the absence of discussions with bidders as to the exact capabilities and possible variations of what is being offered. For that purpose, the contracting authority may wish to divide the selection proceedings into two stages and allow a certain degree of flexibility for discussions with bidders.

61. Where the selection procedure is divided in two stages, the initial request for proposals typically calls upon the bidders to submit proposals relating to broad output specifications and other characteristics of the project as well as to the envisaged contractual terms. The invitation for bids would allow bidders to offer their own solutions for meeting the particular infrastructure need in accordance with defined standards of service. The proposals submitted at this stage would typically consist of solutions on the basis of a conceptual design or performance indicators without indication of financial elements, such as the expected tariff or level of remuneration.

62. To the extent the terms of the contractual arrangements are already known by the contracting authority, they should be included in the request for proposals, possibly in the form of a draft of the project agreement. Knowledge of certain contractual terms, such as the risk allocation envisaged by the contracting authority, is important in order for the bidders to formulate their proposals and discuss the "bankability" of the project with potential lenders. The initial response to those contractual terms, in particular the risk allocation envisaged by the contracting authority, may help the contracting authority assess the feasibility of the project as originally conceived. However, it is important to distinguish between the procedure to request proposals and the negotiation of the final contract, after the project has been awarded. The purpose of this initial stage is to enable the contracting authority to formulate its requirement subsequently in a manner that enables a final competition to be carried out on the basis of a single set of parameters. The invitation of initial proposals at this stage should not lead to a negotiation of the terms of the contract prior to its final award.

63. The contracting authority may then convene a meeting of bidders to clarify questions concerning the request for proposals and accompanying documentation. The contracting authority may, in the first stage, engage in discussions with any bidder concerning any aspect of its proposal. The contracting authority should treat proposals in such a manner as to avoid the disclosure of their contents to competing bidders. Any discussions need to be confidential, and one party to the discussions should not reveal to any other person any technical, financial or other information relating to the discussions without the consent of the other party.

64. Following those discussions, the contracting authority should review and, as appropriate, revise the initial output specifications. In formulating those revised specifications, the contracting authority should be allowed to delete or modify any aspect of the technical or quality characteristics of the project originally set forth in the request for proposals, and any criterion originally set forth in those documents for evaluating and comparing proposals. Any such deletion, modification or addition should be communicated to bidders in the invitation to submit final proposals. Bidders not wishing to submit a final proposal should be allowed to withdraw from the selection proceedings without forfeiting any security that they may have been required to provide.

2. Content of the final request for proposals

65. At the final stage, the contracting authority should invite the bidders to submit final proposals with respect to the revised performance indicators (or technical specifications, as appropriate) and contractual terms.

66. The request for proposals should generally include all information necessary to provide a basis for enabling the bidders to submit proposals that meet the needs of the contracting authority and that the contracting authority can compare in an objective and fair manner.

(a) General information to bidders

67. General information to bidders should cover, as appropriate, those items which are ordinarily included in solicitation documents or requests for proposals for the procurement of goods, construction and services (cf., for example, articles 27 and 38 of the UNCITRAL Model Law). It includes, for example:

(a) Instructions for preparing and submitting proposals, including the manner, place and deadline for the submission of proposals and the period of time during which proposals shall be in effect and any requirements concerning tender securities;

(b) The means by which bidders may seek clarifications of the request for proposals, and a statement as to whether the contracting authority intends, at this stage, to convene a meeting of bidders;

(c) The place, date and time for the opening of proposals and the procedures to be followed for opening and examining proposals;

(d) The manner in which the proposals will be evaluated. Particularly important is the disclosure of the criteria to be used by the contracting authority in determining the successful proposal, including any margin of preference and any criteria other than price to be used, and the relative weight of such criteria (see paras. 83-86).

68. If alternative proposals, including variations to non-mandatory elements of the request for proposals, are admitted, the contracting authority should indicate the manner in which they would be compared and evaluated. Alternative proposals should be rejected if they are not accompanied

by a fully responsive proposal. Where the contracting authority further reserves the right to reject all proposals, without incurring liability towards bidders, such as compensation for their costs of preparing and submitting proposals, a statement to that effect should be included in the request for proposals.

(b) Technical specifications and performance indicators

69. The level of detail provided in the specifications, as well as the appropriate balance between the input and output elements, will be influenced by considerations of issues such as the type and ownership of the infrastructure and the allocation of responsibilities between the public and the private sectors (see paras. 25-26). It is generally advisable for the contracting authority to bear in mind the long-term needs of the project and to formulate its specifications in a manner that allows it to obtain sufficient information to select the bidder that offers the highest quality of services at the best economic terms.

70. Generally, when the contracting authority invites proposals on the basis of a single set of technical specifications the request for proposals typically includes the following information:

(a) Description of the works and services to be performed, including technical specifications, plans, drawings and designs;

(b) The location where the construction is to be effected and the services to be provided;

(c) Time schedule for the execution of works and provision of services;

(d) The technical requirements for the operation and maintenance of the facility.

71. Where the contracting authority requests proposals on the basis of performance indicators, it is important to formulate them in a way that defines adequately the output and performance required without being overly prescriptive in how that is to be achieved. Performance indicators typically cover items such as the following:

(a) Description of project and expected output. If the services require specific buildings, such as a transport terminal or an airport, the contracting authority may wish to provide no more than outline planning concepts for the division of the site as usage zones on an illustrative basis, instead of plans indicating the footprint of individual buildings, as would normally be the case in traditional procurement of construction services;

(b) Minimum applicable design and performance standards, including appropriate environmental standards. Performance standards are typically formulated in terms of the desired quantity and quality of the outputs of the facility. Proposals which deviate from the relevant performance standards should be regarded as non-responsive;

(c) Requirements for the expansion of service;

(d) Quality of maintenance of facilities;

(e) Attention to customers;

(f) Economic and financial soundness of the concessionaire.

72. Each of the above-mentioned performance indicators may require the submission of additional information by the bidders, according to the project being awarded. For the award of a concession for distribution of electricity in a specific region, for example, they may include minimum technical standards such as: (a) specified voltage (and frequency) fluctuation at consumer level; (b) outage duration (expressed in hours per year); (c) outage frequency (expressed in a number per year); (d) losses; (e) number of days to connect a new customer; (f) commercial standards for customer relationship (e.g. number of days to pay bills; to reconnect installations; to respond to customers' complaints).

(c) Contractual terms

73. It is advisable that the bidding documents provide some indication of how the contracting authority expects to allocate the project's risks. This is important in order to set the terms of debate for the detailed negotiations on the project agreement. If risk allocation is left entirely open, the bidders may likely respond by seeking to minimize the risks they accept, which may frustrate the purpose of seeking private investment for developing the project. Furthermore, the request of proposals should contain information on essential elements of the contractual arrangements envisaged by the contracting authority, such as:

(a) The duration of the concession or invitations to bidders to submit proposals for the duration of the concession;

(b) Formula and price indices to be used in adjustments to tariffs;

(c) Government support and investment incentives, if any;

(d) Bonding requirements;

(e) Requirements of regulatory bodies, if any;

(f) Monetary rules and regulations governing foreign exchange remittances;

(g) Revenue sharing arrangements, if any;

(h) Indication of the categories of assets which the concessionaire would be required to transfer to the contracting authority or make available to a successor concessionaire at the end of the project period;

(i) Where a new concessionaire is being selected to operate an existing infrastructure, a description of the assets and property that will be made available to the concessionaire;

(j) The possible alternative, supplementary or ancillary revenue sources (e.g. concessions for exploitation of existing infrastructure), if any, that may be offered to the successful bidder.

74. In order to establish clearly the scope of the negotiations that will take place following the evaluation of proposals (see paras. 92-93), the final request for proposals should indicate which are the terms of the project agreement that are deemed not negotiable.

3. Clarifications and modifications

75. It is desirable to establish procedures for clarification and modification of the request for proposals in a manner that will foster efficient, fair and successful conduct of selection proceedings. The right of the contracting authority to modify the request for proposals is important in order to enable it to obtain what is required to meet its needs. It is also desirable to authorize the contracting authority, whether on its own initiative or as a result of a request for clarification by a bidder, to modify the request for proposals by issuing an addendum at any time prior to the deadline for submission of proposals. However, in case of extensive amendments of the request for proposals, the deadline for submission of proposals may need to be extended.

76. Generally, clarifications, together with the questions that gave rise to the clarifications, and modifications must be communicated promptly by the contracting authority to all bidders to whom the contracting authority provided the request for proposals. If the contracting authority convenes a meeting of bidders, it should prepare minutes of the meeting containing the requests submitted at the meeting for clarification of the request for proposals, and its responses to those requests, without identifying the sources of the requests, and send copies to the bidders.

4. Content of the final proposals

(a) Technical proposals

77. The technical proposals to be submitted by the bidders should include the following information:

(a) Operational feasibility of the project, which shall indicate the proposed organization, methods and procedures for the operation and maintenance of the project under bidding;

(b) Technical soundness of the preliminary engineering design, including proposed schedule of works;

(c) Preliminary environmental assessment, indicating the possible adverse effects of the project on the environment and the corresponding mitigating measures;

(d) Project cost including operating and maintenance cost requirements and proposed financing plan (e.g. proposed equity contribution, debt);

(e) Bid security (see paras. 81-82).

78. It is useful for the contracting authority to require that the final proposals submitted by the bidders contain evidence showing the comfort of the bidder's preferred lenders with the proposed commercial terms and allocation of risks, as outlined in the request for proposals. Such a requirement might play a useful role in resisting pressures to reopen commercial terms at the stage of final negotiations. In some countries, bidders are required to initial and return to the contracting authority the draft project agreement together with their final proposals as a confirmation of their acceptance of all terms in respect of which they did not propose specific amendments.

(b) Financial proposals

79. For projects in which the concessionaire's income is expected to consist primarily of tolls, fees or charges paid by the customers or users of the infrastructure facility, the financial proposal should indicate the proposed tariff structure. For projects in which the concessionaire's income is expected to consist primarily of payments made by the contracting authority or another Governmental agency to amortize the concessionaire's investment, the financial proposal should indicate the proposed amortization payments and repayment period. Furthermore, for either case the financial proposals should include:

(a) The present value of the proposed charges or amortization payments based on the discounting rate and foreign exchange rate prescribed in the bidding documents;

(b) The proposed duration of the concession, where it is not specified in the request for proposals;

(c) Level of governmental financial support required for the project, including, as appropriate, any subsidy or guarantee expected from the contracting authority;

(d) The extent of risks assumed by the bidders during construction and operation phase, including unforeseen events, insurance, equity investment and other guarantees against those risks.

(c) Feasibility studies

80. Feasibility studies are particularly important in privately financed infrastructure projects and should cover, for instance, the following aspects:

(a) *Commercial viability*: particularly in projects financed on a non-recourse or limited recourse basis, it is essential to establish the need for the project outputs and to evaluate and project such needs over the proposed operational life of the project, including expected demand (e.g. traffic forecasts for roads) and pricing (e.g. tolls);

(b) *Engineering design and operational feasibility*: bidders should be requested to demonstrate the suitability of the technology they propose, including equipment and processes,

to national, local and environmental conditions, the likelihood of achieving the planned performance level and the adequacy of the construction methods and schedules. This study should also define the proposed organization, methods and procedures for operating and maintaining the completed facility;

(c) *Financial viability*: bidders should be requested to indicate the proposed sources of financing for the construction and operation phases, including debt capital and equity investment. While the loan and other financing agreements in most cases are not executed until after the signing of the project agreement, the bidders should be required to submit sufficient evidence of the lenders' intention to provide the specified financing. In some countries, bidders are also required to indicate the expected financial internal rate of return in relation to the effective cost of capital corresponding to the financing arrangements proposed. Such information is intended to allow the contracting authority to consider the reasonableness and affordability of the proposed tariffs or prices to be charged by the concessionaire and the potential for subsequent increases therein;

(d) *Environmental impact*: this study should identify possible negative or adverse effects on the environment as a consequence of the project and indicate corrective measures that need to be taken.

(d) Bid securities

81. It is advisable for the laws or regulations governing the selection process to authorize the contracting authority to require the bidders to post a bid security so as to cover those losses that may result from withdrawal of proposals or failure by the selected bidder to conclude a project agreement.

82. It is advisable that the request for proposals indicate any requirements of the contracting authority with respect to the issuer and the nature, form, amount and other principal terms of any bid security to be provided by bidders submitting proposals. In order to ensure a fair treatment of all bidders, requirements that refer directly or indirectly to the conduct by the bidder submitting the proposal should not relate to conduct other than: withdrawal or modification of the proposal after the deadline for submission of proposals, or before the deadline if so stipulated in the request for proposals; failure to achieve financial closing; failure to sign the project agreement if required by the contracting authority to do so; and failure to provide a required security for the performance of the project agreement after the proposal has been accepted or to comply with any other condition precedent to signing the project agreement specified in the request for proposals. Safeguards should be included to ensure that a bid-security requirement is only imposed fairly and for the intended purpose.6/

6/ Article 32 of the UNCITRAL Model Law provides certain important safeguards, including, *inter alia*, the requirement that the contracting authority should make no claim to the amount of the tender security, and should promptly return, or procure the return of, the tender security document, after whichever of the following that occurs earliest: (a) the expiry of the tender security; (b) the entry into force of the project agreement and the provision of a security for the performance of the contract, if such a security is required by

5. Evaluation criteria

83. The award committee should rate the technical and financial elements of each proposal in accordance with the predisclosed rating systems for the technical evaluation criteria and specify in writing the reasons for the rating. Generally, it is important for the contracting authority to achieve an appropriate balance between evaluation criteria relating to the physical investment (e.g. the construction works) and evaluation criteria relating to the operation of the infrastructure and the quality of services to be provided by the concessionaire. Adequate emphasis should be given to the long term needs of the contracting authority, in particular the need to ensure the continuous delivery of the service at the required level of quality and safety.

84. Technical evaluation criteria are designed to facilitate the assessment of the technical, operational, environmental, and financing viability of the proposal vis-à-vis the prescribed specifications, indicators and requirements prescribed in the bidding documents. To the extent practicable, the technical criteria applied by the contracting authority should be objective and quantifiable, so as to enable proposals to be evaluated objectively and compared on a common basis. This reduces the scope for discretionary or arbitrary decisions. Regulations governing the selection process might spell out how such factors are to be formulated and applied. Technical proposals for privately financed infrastructure projects are usually evaluated in accordance with the following criteria:

(a) *Technical soundness*. Where the contracting authority has established minimum engineering design and performance specifications or standards, the basic design of the project should conform to those specifications or standards. Bidders should be required to demonstrate the soundness of the proposed construction methods and schedules;

(b) *Operational feasibility*. The proposed organization, methods, and procedures for operating and maintaining the completed facility must be well defined, should conform to the prescribed performance standards, and should be shown to be workable. Where feasible, it should provide for the transfer of technology used in every phase of the project;

(c) *Quality of services*. Evaluation criteria used by the contracting authority may include an analysis of the manner in which the bidders undertake to maintain and expand the service, including the guarantees offered for ensuring its continuity;

(d) *Environmental standards*. The proposed design and the technology of the project to be used should be in accordance with the environmental standards set forth in the request for proposals. Any negative or adverse effects on the environment as a consequence of the project as proposed by the bidders should be properly identified, including the corresponding corrective or mitigating measures;

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the request for proposals; (c) the termination of the selection process without the entry into force of a project agreement; or (d) the withdrawal of the proposal prior to the deadline for the submission of proposals, unless the request for proposals stipulates that no such withdrawal is permitted.

(e) *Financial viability*. Technical proposals should demonstrate that the proposed financing plan is adequate to meet the construction, operating and maintenance costs of the project. The contracting authority should assess whether the financing proposals of the bidders adequately meet the cost requirements of the project;

(f) *Enhancements*. Other terms which the project proponent may offer to make the proposals more attractive, such as revenue-sharing with the contracting authority, less governmental guarantees or reduction in the level of Government support.

85. In addition to criteria for the technical evaluation of proposals, the contracting authority needs to define criteria for assessing and comparing the financial proposals. For projects in which the concessionaire's income is expected to consist primarily of tolls, fees or charges paid by the customers or users of the infrastructure facility, the assessment and comparison of the financial elements of the final proposals is typically based on the present value of the proposed tolls, fees, rentals and other charges over the concession period according to the prescribed minimum design and performance standards. For projects in which the concessionaire's income is expected to consist primarily of payments made by the contracting authority to amortize the concessionaire's investment, the assessment and comparison of the financial elements of the final proposals is typically based on the present value of the proposed schedule of amortization payments for the facility to be constructed according to the prescribed minimum design and performance standards, plans and specifications. However, the contracting authority's assessment of financial elements of the final proposals should not be limited to a comparison of the unit prices offered for the expected output. In order to consider adequately the financial feasibility of the proposals and the likelihood of subsequent increases in the proposed prices, additional criteria may need to be considered, such as the costs for design and construction activities; annual operation and maintenance costs; present value of capital costs and operating costs; and the amount of subsidy, if any, expected from the Government.

86. Evaluation of financial proposals vary in form and complexity depending on the form of the desired private participation. In some cases the financial proposal may include the cost of financing offered by bidders; in this case the requirement for financing and how it will be considered in the evaluation of proposals should be defined in the request for proposals. In establishing the criteria for the evaluation of financial proposals, it is important for the contracting authority to consider carefully the relative importance of the proposed unit price for the expected output as an evaluation criterion. While the unit price is an important factor for ensuring objectiveness and transparency in the choice between equally responsive proposals, it should be noted that the notion of "price" usually does not have the same value for the award of privately financed infrastructure projects as it has in the procurement of goods and services. Indeed, the remuneration of the concessionaire is often the combined result of charges paid by the users, ancillary revenue sources and direct subsidies or payments made by the public entity awarding the contract. Therefore, while the unit price for the expected output retains its role as an important element of comparison of proposals, it may not always be regarded as the most important factor.

6. Submission, opening, comparison and evaluation of proposals

87. Proposals should be required to be submitted in writing, signed and in sealed envelopes. Proposals received by the contracting authority after the deadline for the submission of proposals should not be opened and should be returned to the bidder that submitted it.

88. For the purpose of ensuring transparency, national laws often prescribe formal procedures for the opening of proposals, usually at a time previously specified in the request for proposals, and require that the bidders that have submitted proposals, or their representatives, be permitted by the contracting authority to be present at the opening of proposals. Such a requirement helps to minimize the risk that the proposals might be altered or otherwise tampered with and represents an important guarantee of the integrity of the proceedings.

89. In view of the complexity of privately financed infrastructure projects and the variety of evaluation criteria usually applied in the award of the project, in some countries bidders are required to formulate and submit their technical and financial proposals in two separate envelopes. The two-envelope system is sometimes used because it permits the contracting authority to evaluate the technical quality of proposals without being influenced by their financial components. However, the method has been criticized as being contrary to the objective of economy in the award of public contracts. In particular, there is said to be a danger that, by selecting proposals initially on the basis of technical merit alone and without reference to price, a contracting authority might be tempted to select, upon the opening of the first envelope, proposals offering technically superior works and to reject proposals offering less sophisticated solutions that nevertheless meet the contracting authrority's needs at an overall lower cost. International financial institutions, such as the World Bank, do not accept the two-envelope system for projects financed by them because of concerns that the system gives margin to a higher degree of discretion in the evaluation of proposals and makes it more difficult to compare them in an objective manner

90. As an alternative to the use of a two-envelope system, the awarding authorities may require both technical and financial proposals to be contained in one single proposal, but structure their evaluation in two stages, as in the evaluation procedure provided in article 42 of the UNCITRAL Model Law. In an initial stage, the contracting authority typically establishes a threshold with respect to quality and technical aspects to be reflected in the technical proposals in accordance with the technical criteria as set out in the proposals, and rates each technical proposal in accordance with such criteria and the relative weight and manner of application of those criteria as set forth in the request for proposals. The contracting authority then compares the financial proposals that have attained a rating at or above the threshold. When the technical and financial proposals are to be evaluated consecutively, the contracting authority should initially ascertain whether the technical proposals are *prima facie* responsive to the request for proposals (e.g. whether they cover all items required to be addressed in the technical proposals). Incomplete or partial proposals, as well as proposals that deviate from the request for proposals, should be rejected at this stage. While the contracting authority may ask bidders for clarifications of their proposals, no change in a matter of substance in the proposal, including changes aimed at making an unresponsive proposal responsive, should be sought, offered or permitted at this stage.

91. In addition to deciding whether to use a two-envelope system or a two-stage evaluation procedure, it is important for the contracting authority to disclose the relative weight to be accorded to each evaluation criterion and the manner in which they are to be applied in the evaluation of proposals. Two possible approaches might be used to reach an appropriate balance between financial and technical aspects of the proposals. One possible approach is to consider as most advantageous the proposal that obtains the highest combined rating in respect of both price and non-price evaluation criteria. Alternatively, the price proposed for the output (e.g. the water or electricity tariff, the level of tolls) might be the deciding factor for establishing the winning proposal among the responsive proposals (i.e. those that have passed the threshold with respect to quality and technical aspects). In any event, in order to promote the transparency of the selection process and to avoid improper use of non-price evaluation criteria, it is advisable to require the awarding committee to provide a written justification of the reasons for selecting a proposal other than the one offering the lowest unit price for the output.

7. Final negotiations

92. The contracting authority should rank all responsive proposals on the basis of the evaluation criteria set forth in the request for proposals and invite for final negotiation of the project agreement the bidder that has attained the best rating or, as appropriate, the one that offered the lowest price for the output among those that attained the minimum threshold in respect of technical aspects. The final negotiations should be limited to fixing the final details of the transaction documentation and satisfying the reasonable requirements of the selected bidder's lenders. One particular problem faced by awarding authorities is the danger that the negotiations with the selected bidder might lead to pressures to amend, to the detriment of the Government or the consumers, the price or risk allocation originally contained in the proposal. Changes in essential elements of the proposal should not be permitted, as they may distort the assumptions on the basis of which the proposals were submitted and rated. Therefore, the negotiations at this stage may not concern those terms of the contract that were deemed not negotiable in the final request for proposals. The risk of re-opening commercial terms at this late stage could be further minimized by insisting that the selected bidder's lenders indicate their comfort with the risk allocation embodied in their bid at a stage where there is competition among bidders (see para. 78). The contracting authority's financial advisers might contribute to this process by advising whether bidders' proposals are realistic, and what levels of financial commitment are appropriate at each stage. The process of reaching financial close can itself be quite lengthy.

93. The contracting authority should inform the remaining responsive bidders that they may be considered for negotiation if the negotiations with the bidder with better ratings do not result in a project agreement. If it becomes apparent to the contracting authority that the negotiations with the bidder invited will not result in a project agreement, the contracting authority should inform that bidder that it is terminating the negotiations and then invite for negotiations the next bidder on the basis of its ranking until it arrives at a project agreement or rejects all remaining proposals. To avoid the possibility of abuse and unnecessary delay, the awarding entity should not reopen negotiations with any bidder with whom they had already been terminated.

8. Notice of project award

94. Project agreements frequently include provisions that are of direct interest for parties other than the contracting authority and the concessionaire, and who might have a legitimate interest in being informed about certain essential elements of the project. This is particularly the case for projects involving the provision of a service directly to the general public. For transparency purposes, it may be advisable to establish procedures for publicizing those terms of the project agreement that may be of public interest. One possible procedure may be to require the contracting authority to publish a notice of the award of the project, indicating, *inter alia*, the following elements: (a) the name of the concessionaire; (b) the annexes and enclosures that form part of the agreement; (c) a description of the works and services to be performed by the concessionaire; (d) the duration of the concession; (e) the tariff structure; (f) the rights and obligations of the concessionaire and the guarantees to be provided by it; (g) the monitoring rights of the contracting authority and remedies for breach of the project agreement; (h) the obligations of the Government, including any payment, subsidy or compensation offered by the Government; and (i) any other essential term of the project agreement, as provided in the request for proposals. Where such a system is used, it is important to ensure consistency between the notice of award and the project agreement.

D. Direct negotiations

95. In the legal tradition of certain countries, privately financed infrastructure projects involve the delegation by the contracting authority of the right and duty to provide a public service. As such, they are subject to a special legal regime that differs in many respects from the regime that applies generally to the award of public contracts for the purchase of goods, construction or services.

96. In those legal systems, the Government generally has the choice of a number of procedures for the award of public contracts for the purchase of goods or services. As a general rule, those procedures involve publicity requirements, competition and the strict application of pre-established award criteria. The most common procedure is the tendering method, in which the contract is awarded to the tenderer offering the lowest price. While there also exist less rigid procedures, such as the request for proposals, which allows for consideration of other elements in addition to price (e.g. operating cost, technical merit and proposed completion time), negotiations are only resorted to under exceptional circumstances. However, those countries apply different procedures for the award of privately financed infrastructure projects. Given the very particular nature of the services required (e.g. complexity, amount of investment and completion time), the procedures used place the accent on the contracting authority's freedom to choose the operator who best suits its need, in terms of professional qualification, financial strength, ability to ensure the continuity of the service, equal treatment of the users and quality of the proposal. In contrast to the competitive selection procedures usually followed for the award of public contracts, which sometimes may appear to be excessively rigid, selection by direct negotiation is characterized by a high degree of flexibility as to the procedures involved and discretion on the part of the contracting authority. However, freedom of negotiation does not mean arbitrary choice and the laws of those countries provide procedures to ensure transparency and fairness in the conduct of the selection process.

97. In other countries, where tendering is under normal circumstances the rule for the award of public contracts, guidelines issued to awarding authorities advise the use of direct negotiations whenever possible for the award of privately financed infrastructure projects. The rationale for encouraging negotiations in those countries is that in negotiating with bidders the Government is not bound by pre-determined requirements or rigid specifications and has more flexibility for taking advantage of innovative or alternative proposals that may be submitted by the bidders in the selection proceedings, as well as for changing and adjusting its own requirements in the event that more attractive options for meeting the infrastructure needs are formulated during the negotiations.

98. Negotiated methods generally afford a high degree of flexibility that some countries may find beneficial to the selection of the concessionaire. However, negotiated methods may have a number of disadvantages that make them less suitable to be used as a principal selection method in a number of countries. Because of the high level of flexibility and discretion afforded to the contracting authority, negotiated methods require highly skilled personnel with sufficient experience in negotiating complex projects. They also require a well structured negotiation team, clear lines of authority and a high level of coordination and cooperation among all the offices involved. Therefore, the use of negotiations for the award of privately financed infrastructure projects may not represent a viable alternative for countries that do not have the tradition of using such methods for the award of large Government contracts. Another disadvantage of negotiated methods is that they may not ensure the level of transparency and objectivity that can be achieved by more structured competitive methods. In some countries there might be concerns that the higher level of discretion in negotiated methods might carry with it a higher risk of abusive or corrupt practices. In the light of the above, the host country may wish to prescribe the use of the competitive selection procedures as a rule for the award of privately financed infrastructure projects and reserve direct negotiations only for exceptional cases.

1. Circumstances authorizing the use of direct negotiations

99. For transparency purposes as well as for ensuring discipline in the award of projects, it might be generally desirable for the law to identify the exceptional circumstances that may authorize the use of direct negotiations. They may include, for example, the following:

(a) When there is an urgent need for ensuring immediate provision of the service, and engaging in a competitive selection procedure would therefore be impractical, provided that the circumstances giving rise to the urgency were neither foreseeable by the contracting authority nor the result of dilatory conduct on its part. Such an exceptional authorization may be needed, for instance, in cases of interruption in the provision of a given service or where an incumbent concessionaire fails to provide the service at acceptable standards or if the project agreement is rescinded by the contracting authority, when engaging in a competitive selection procedure would be impractical in view of the urgent need to ensure the continuity of the service;

(b) In case of projects of short duration and with an anticipated initial investment value not exceeding a specified low amount;

(c) Reasons of national defence;

(d) Cases where there is only one source capable of providing the required because it can be provided only by the use of patented technology or unique know

(e) Lack of experienced personnel or of an adequate administrative structu competitive selection procedures.

100. In addition to the above, after a competitive selection procedure has be situations might arise under which the contracting authority may prefer to change method in favour of direct negotiations. This may be particularly the case when an the preselection proceedings or a request for proposals has been issued but no ap proposals were submitted, or all proposals were rejected by the contracting authorit in the judgement of the contracting authority, issuing a new request for propos unlikely to result in a project award. In such a case, the contracting authority mi enter into negotiations with responsive bidders, as a an alternative to having to reject and start another procedure with possible uncertain results.

2. Measures to enhance transparency in direct negotiations

101. Procedures to be followed in procurement through negotiation are typically by a higher degree of flexibility than the procedures applied to other methods of p Few rules and procedures are established to govern the process by which the parties conclude their contract. In some countries, procurement laws allow contractin virtually unrestricted freedom to conduct negotiations as they see fit. The laws of ot establish a procedural framework for negotiation designed to maintain fairness and o to bolster competition by encouraging participation of bidders. Provisions on pr selection through negotiation address a variety of issues discussed below, i requirements for approval of the contracting authority's decision to select the c through negotiation, selection of negotiating partners, criteria for comparison and offers, and recording of the selection proceedings.

(a) Approval

102. A threshold requirement found in many countries is that a contracting author approval of a higher authority prior to engaging in selection through negotiation. Su generally require the application for approval to be in writing and to set forth necessitating the use of negotiation. Approval requirements are intended, in particu that the negotiation method of selection is used only in appropriate circumstances.

(b) Selection of negotiating partners

103. In order to make the negotiation proceedings as competitive as possible, it i require the contracting authority to engage in negotiations with as many comp susceptible of meeting the need as circumstances permit. Beyond such a general pr is no specific provision in the laws of some countries on the minimum number of c

suppliers with whom the contracting authority is to negotiate. The laws of some other countries, however, require the contracting authority, where practicable, to negotiate with, or to solicit proposals from, a minimum number of bidders (e.g. three). The contracting authority is permitted to negotiate with a smaller number in certain circumstances, in particular, when less than the minimum number of contractors or suppliers were available.

104. For the purpose of enhancing transparency, it is also advisable to require a notice of the negotiation proceedings to be given to bidders in a specified manner. For example, the contracting authority may be required to publish the notice in a particular publication normally used for that purpose. Such notice requirements are intended to bring the procurement proceedings to the attention of a wider range of bidders than might otherwise be the case, thereby promoting competition. Given the magnitude of most infrastructure projects, the notice should normally contain certain minimum information (e.g. description of the project, qualification requirements) and should be issued in sufficient time to allow bidders to prepare offers. Generally the formal eligibility requirements applicable to bidders in competitive selection proceedings should also apply in negotiation proceedings.

105. In some countries, notice requirements are waived when the contracting authority resorts to negotiation following unsuccessful tendering proceedings (see para. 100), if all qualified contractors or suppliers that submitted tenders are permitted to participate in the negotiations or if no tenders at all were received.

(c) Criteria for comparison and evaluation of offers

106. Another useful measure to enhance transparency and effectiveness of direct negotiations consists of establishing general criteria that proposals are requested to meet (e.g. general performance objectives, output specifications), as well as criteria for comparing and evaluating offers made during the negotiations and for selecting the winning concessionaire (e.g. the technical merit of an offer, tariffs, operating and maintenance costs, the effect of the contract terms on the concessionaire, and the profitability and development potential of the project agreement). The contracting authority should identify the proposals that appear to meet those criteria and engage in discussions with the author of each such proposal in order to refine and improve upon the proposal to the point where it is satisfactory to the contracting authority. The price of each proposal does not enter into those discussions. When the proposals have been finalized, it may be advisable for the contracting authority to seek a best and final offer on the basis of the clarified proposals. It is recommendable that bidders should include with their final offer evidence that the risk allocation that the offer embodies would be acceptable to their proposed lenders. From the best and final offers received, the preferred bidder can then be chosen. The project would then be awarded to the party offering the "most economical" or "most advantageous" proposal. It is recommended that the contracting authority's intention to seek a best and final offer or not should be stated in the invitation to negotiate.

(d) Record of selection proceedings

107. The contracting authority should be required to establish a record of the selection proceedings. The record should include information concerning the circumstances necessitating

the use of negotiation, the contractors or suppliers invited to negotiate, the contractors or suppliers that requested to participate, and the contractors or suppliers that were excluded from participating and the grounds for their exclusion.

E. Unsolicited proposals

108. Government agencies are sometimes approached directly by private companies who submit proposals for the development of projects in respect of which no selection procedures have been opened. These proposals are usually referred to as "unsolicited proposals". Unsolicited proposals may result from the identification by the private sector of an infrastructure need that may be met by a privately financed project. They may also involve innovative proposals for infrastructure management and offer the potential for transfer of new technology to the host country.

109. The main issue raised by unsolicited proposals is whether or not it is advisable to authorize the contracting authority to negotiate unsolicited proposals directly with the bidder or whether unsolicited proposals, too, need to be awarded pursuant to the generally applicable award procedures.

1. Policy considerations

110. One possible reason sometimes cited for waiving the requirement of competitive selection procedures is to provide an incentive for the private sector to submit proposals involving the use of new concepts or technologies to meet the contracting authority's needs. By the very nature of competitive selection procedures, no bidder has an assurance of being awarded the project, unless it wins the competition. The cost of formulating proposals for large infrastructure projects may be a deterrent for companies concerned about their ability to match proposals submitted by competing bidders. In contrast, the private sector may see an incentive for the submission of unsolicited proposals in rules that allow a contracting authority to negotiate such proposals directly with their authors. The contracting authority, too, may have an interest in the possibility of engaging in direct negotiations in order to stimulate the private sector to formulate innovative proposals for infrastructure development.

111. At the same time, however, the award of projects pursuant to unsolicited proposals and without competition from other bidders may expose the Government to serious criticism, particularly in cases involving exclusive concessions. In addition to that, prospective lenders, including multilateral and bilateral financial institutions, may have difficulties in lending or providing guarantees for projects that have not been the subject of competitive selection proceedings. They may fear the possibility of challenge and cancellation by future governments (e.g. because the project award may be subsequently deemed to be the result of favouritism or because the procedure did not provide objective parameters for comparing prices, technical elements and the overall effectiveness of the project) or legal or political challenge by other interested parties, such as customers dissatisfied with increased tariffs or competing companies alleging unjust exclusion from a competitive selection procedure.

112. In the light of the above considerations, it is important for the host country to consider the need for, and the desirability of, devising special procedures for handling unsolicited proposals which deviate from the procedures usually followed for the award of privately financed infrastructure projects. For that purpose, in may be useful to analyse two situations most commonly mentioned in connection with unsolicited proposals, namely: unsolicited proposals claiming to involve the use of new concepts or technologies to address the contracting authority's infrastructure needs, and unsolicited proposals claiming to address an infrastructure need not already identified by the contracting authority.

(a) Unsolicited proposals claiming to involve the use of new concepts or technologies to address the contracting authority's infrastructure needs

113. Generally, for infrastructure projects which require the use of some kind of industrial process or method, the contracting authority would have an interest in stimulating the submission of proposals incorporating the most advanced processes, designs, methodologies or engineering concepts with demonstrated ability to enhance the project's outputs (e.g. by significantly reducing construction costs, accelerating project execution, improving safety, enhancing project performance, extending economic life, reducing costs of facility maintenance and operations, or reducing negative environmental impact or disruptions during either the construction or the operation phase of the project).

114. The contracting authority's legitimate interests might also be achieved through appropriately modified competitive selection procedures instead of a special set of rules for handling unsolicited proposals. For instance, if the contracting authority is using selection procedures which emphasize the expected output of the project, without being prescriptive about the manner in which that output is to be achieved (see paras. 71-72), the bidders would have sufficient flexibility for offering their own proprietary processes or methods. In such a situation, the fact that each of the bidders has its own proprietary processes or methods would not pose an obstacle to competition, provided that all the proposed methods are technically capable of generating the output expected by the contracting authority.

115. Adding the necessary flexibility to the competitive selection procedures may in these cases be a more satisfactory solution than devising special non-competitive procedures for dealing with proposals claiming to involve new concepts or technologies. With the possible exception of proprietary concepts or technologies whose uniqueness may be ascertained on the basis of the existing intellectual property rights a contracting authority may face considerable difficulties in defining what constitutes a new concept or technology. Such determination may require the services of costly independent experts, possibly from outside the host country to avoid allegations of bias. A determination that a project involves a novel concept or technology might also be met by claims from other interested companies also claiming to have appropriate new technologies.

116. However, a somewhat different situation may arise if the uniqueness of the proposal or its innovative aspects are such that it would not be possible to implement the project without using a process, design, methodology or engineering concept for which the proponent or its partners possess exclusive rights, either worldwide or regionally. The existence of intellectual property rights in respect of a method or technology may indeed reduce or eliminate the scope for

meaningful competition. This is why the procurement laws of most countries authorize procuring entities to engage in single-source procurement if the goods, construction or services are available only from a particular supplier or contractor, or the particular supplier or contractor has exclusive rights in respect of the goods, construction or services, and no reasonable alternative or substitute exists (cf. UNCITRAL Model Law, article 22).

117. In such a case, it would be appropriate to authorize the contracting authority to negotiate the execution of the project directly with the proponent of the unsolicited proposal. The difficulty, of course, would be how to establish, with the necessary degree of objectivity and transparency, that there exists no reasonable alternative or substitute to the method or technology contemplated in the unsolicited proposal. For that purpose, it is advisable for the contracting authority to establish procedures for obtaining elements of comparison for the unsolicited proposal.

(b) Unsolicited proposals claiming to address an infrastructure need not already identified by the contracting authority

118. The merit of unsolicited proposals of this type consists of the identification of a potential for infrastructure development which has not been considered by the authorities of the host country. However, in and of itself this circumstance should not normally provide sufficient justification for a directly negotiated project award in which the contracting authority has no objective assurance that it has obtained the most advantageous solution for meeting its needs.

2. Procedures for handling unsolicited proposals

119. In the light of the above considerations, it is advisable for the contracting authority to establish transparent procedures for determining whether an unsolicited proposal meets the required conditions and whether it is in the contracting authority's interest to pursue it.

(a) Restrictions to the receivability of unsolicited proposals

120. In the interest of ensuring proper accountability for public expenditures, some domestic laws provide further that no unsolicited proposal may be considered if the execution of the project would require significant financial commitments from the contracting authority or other governmental agency such as guarantees, subsidies or equity participation. The reason for such a limitation is that the procedures for handling unsolicited proposals are typically less elaborate than ordinary selection procedures and may not ensure the same level of transparency and competition that would otherwise be achieved. However, there may be reasons for allowing some flexibility in the application of this condition. In some countries, the presence of government support other than direct government guarantees, subsidy or equity participation (e.g. the sale or lease of government assets to project proponents) does not necessarily disqualify a proposal from being treated and accepted as an unsolicited proposal.

121. Another condition for consideration of an unsolicited proposal is that it should relate to a project for which no selection procedures have been initiated or announced by the contracting authority. The rationale for handling an unsolicited proposal without using a competitive selection procedure is to provide an incentive for the private sector to identify new or unanticipated

infrastructure needs or formulate innovative proposals for meeting those needs. This justification may no longer be valid if the project has already been identified by the authorities of the host country and the private sector is merely proposing a technical solution different from the one envisaged by the contracting authority. In such a case, the contracting authority could still take advantage of innovative solutions by applying a two-stage selection procedure or by inviting the submission of alternative proposals within the selection procedures originally foreseen (see paras. 60-84). However, it would not be consistent with the principle of fairness in the award of public contracts to entertain unsolicited proposals outside selection proceedings already started or announced.

(b) Procedures for determining the admissibility of unsolicited proposals

122. The company or group of companies who approach the Government with a suggestion for private infrastructure development should be requested to submit an initial proposal containing sufficient information to allow the contracting authority to make a *prima facie* assessment of whether the conditions for handling unsolicited proposals are met, in particular whether the proposed project is in the public interest. The initial proposal should include, for instance, the following information: statement of the proponent's previous project experience and financial standing; description of the project (type of project, location, regional impact, proposed investment, operational costs, financial assessment, resources needed from the Government or third parties); the site (ownership and whether land or other property will have to be expropriated); a description of the service and the works.

123. Following a preliminary examination, the contracting authority should inform the company, within a reasonably short period, whether or not there is a potential public interest in the project. If the contracting authority reacts positively to the project, the company should be invited to submit a formal proposal which, in addition to the items covered in the initial proposal, should contain a technical and economical feasibility study (including characteristics, costs and benefits) and an environmental impact study. Furthermore, the proponent should be required to submit satisfactory information regarding the concept or technology contemplated in the proposal. The information disclosed should be in sufficient detail to allow the contracting authority to properly evaluate the concept or technology and determine whether it meets the required conditions and is likely to be successfully implemented at the scale of the proposed project. The company submitting the unsolicited proposal should retain title to all documents submitted throughout the procedure, and those documents should be returned to it in the event the proposal is rejected.

124. Once all the required information is provided by the proponent, the contracting authority should decide, within a reasonably short period, whether it intends to pursue the project and, if so, what procedure will be used. The choice of the appropriate procedure should be made on the basis of the contracting authority's preliminary determination as to whether or not the implementation of the project would be possible without the use of a process, design, methodology or engineering concept for which the proponent or its partners possess exclusive rights.

(c) Procedures for handling unsolicited proposals which do not involve proprietary concepts or technology

125. If the contracting authority, upon examination of an unsolicited proposal, decides that there is public interest in pursuing the project, but the implementation of the project is possible without the use of a process, design, methodology or engineering concept for which the proponent or its partners possess exclusive rights, the contracting authority should be required to award the project by using the procedures which would be normally required for the award of privately financed infrastructure projects, such as, for instance, the competitive selection procedures described in this *Guide* (see paras. 39-94). However, the selection procedures may include certain special features so as to provide an incentive to the submission of unsolicited proposals. These incentives may consist of the following measures:

(a) The contracting authority could undertake not to initiate selection proceedings regarding a project in respect of which an unsolicited proposal was received without inviting the company that submitted the original proposal;

(b) The original bidder might be given some form of premium for submitting the proposal. In some countries, the premium takes the form of a margin of preference over the final rating (i.e. a certain percentage over and above the final combined rating obtained by that company in respect of both price and non-price evaluation criteria). One possible difficulty of such a system is the risk of setting the margin of preference so high so as to discourage competing meritorious bids, thus resulting in the receipt of a project of lesser value in exchange for the preference given to the innovative proponent. Alternative forms of incentives may include the reimbursement, in whole or in part, of the costs incurred by the original proponent in the preparation of the unsolicited proposal. For purposes of transparency, any such incentives should be announced in the request for proposals.

126. Notwithstanding the incentives that may be provided, the author of the unsolicited proposal should generally be required to meet essentially the same qualification criteria as would be required of the bidders participating in the competitive selection procedure (see paras. 43-46).

(d) Procedures for handling unsolicited proposals involving proprietary concepts or technology

127. If it appears that the innovative aspects of the proposal are such that it would not be possible to implement the project without using a process, design, methodology or engineering concept for which the proponent or its partners possess exclusive rights, either worldwide or regionally, it may be useful for the contracting authority to confirm that preliminary assessment by applying a procedure for obtaining elements of comparison for the unsolicited proposal. One such procedure may consist in the publication of a summary of the essential terms of the proposal with an invitation for other interested parties to submit alternative or comparable proposals within a certain period. The period should be commensurate with the complexity of the project and should afford the prospective competitors sufficient time for formulating their proposals. This may be a crucial factor for obtaining alternative proposals, for example, if the bidders would have to carry

out detailed sub-surface geological investigations which might have been carried out over many months by the original proponent, who would want the geological findings to remain secret.

128. The invitation for comparative or competitive proposals should be published with a minimum frequency (e.g. once every week for three weeks) in at least one newspaper of general circulation. It should indicate the time and place where bidding documents could be obtained and should specify the time during which proposals may be received. It is important for the contracting authority to protect the intellectual property rights of the original proponent and to ensure the confidentiality of proprietary information received with the unsolicited proposal. Any such information should not form part of the bidding documents. Both the original proponent and any other company that wishes to submit an alternative proposal should be required to submit a bid security (see paras. 81-82). Two possible avenues may then be pursued, according to the answers to reactions received to the invitation:

(a) If no alternative proposals are received, the contracting authority may reasonably conclude that there is no reasonable alternative or substitute to the method or technology contemplated in the unsolicited proposal. This finding of the contracting authority should be appropriately recorded and the contracting authority could be authorized to engage in direct negotiations with the original proponent. It may be advisable to require that the decision of the contracting authority be reviewed and approved by the same authority whose approval would normally be required in order for the contracting authority to select a concessionaire through direct negotiation (see para. 102);

(b) If alternative proposals are submitted, the contracting authority should invite all the proponents to competitive negotiations with a view to identifying the most advantageous proposal for carrying out the project (see paras. 103-105). In the event that the contracting authority receives a sufficiently large number of alternative proposals which appear *prima facie* to meet its infrastructure needs, there may be scope for engaging in full-fledged competitive selection procedures, subject to any incentives that may be given to the author of the original proposal (see para. 125 (b)).

F. Review procedures

129. An important safeguard of proper adherence to the rules governing the selection procedure is that bidders have the right to seek review of actions by the contracting authority in violation of those rules. Various remedies and procedures are available in different legal systems and systems of administration, which are closely linked to the question of review of governmental actions. What is crucial is that, whatever the exact form of review procedures, an adequate opportunity and effective procedures for review should be provided. Elements for the establishment of an adequate review system are contained in chapter VI of the UNCITRAL Model Law.

130. Appropriate review procedures should establish in the first place that suppliers and contractors have a right to seek review. In the first instance, that review may be sought from the contracting authority itself, in particular where the project is yet to be awarded. This may facilitate economy and efficiency, since in many cases, in particular prior to the awarding of the project, the contracting authority may be quite willing to correct procedural errors, of which it

may even not have been aware. It may also be useful to provide for a review by higher administrative organs of the Government, where such a procedure would be consistent with constitutional, judicial and administrative structures. Finally, most domestic procurement regimes affirm the right to judicial review, which should generally also be available in connection with the award of infrastructure projects.

131. In order to strike a workable balance between, on the one hand, the need to preserve the rights of bidders and the integrity of the selection process and, on the other hand, the need to limit disruption of the selection process, domestic laws often include a number of restrictions on the review procedures that it establishes. These include: limitation of the right to review to bidders; time limits for filing of applications for review and for disposition of cases, including any suspension of the selection proceedings that may apply at the level of administrative review; exclusion from the review procedures of a number of decisions that are left to the discretion of the contracting authority and that do not directly involve questions of the fairness of treatment accorded to bidders.

132. There exist in most States mechanisms and procedures for review of acts of administrative organs and other public entities. In some States, review mechanisms and procedures have been established specifically for disputes arising in the context of procurement by those organs and entities. In other States, those disputes are dealt with by means of the general mechanisms and procedures for review of administrative acts. Certain important aspects of proceedings for review, such as the forum where review may be sought and the remedies that may be granted, are related to fundamental conceptual and structural aspects of the legal system and the system of State administration in every country. Many legal systems provide for review of acts of administrative organs and other public entities before an administrative body that exercises hierarchical authority or control over the organ or entity (hereinafter referred to as "hierarchical administrative review"). In legal systems that provide for hierarchical administrative review, the question of which body or bodies are to exercise that function in respect of acts of particular organs or entities depends largely on the structure of the State administration. In the context of general procurement laws, for example, some States provide for review by a body that exercises overall supervision and control over procurement in the State (e.g. a central procurement board); in other States the review function is performed by the body that exercises financial control and oversight over operations of the Government and of the public administration. In some States, the review function in respect of particular types of cases involving administrative organs or other public entities is performed by specialized independent administrative bodies whose competence is sometimes referred to as "quasi-judicial". Those bodies are not, however, considered in those States to be courts within the judicial system.

133. Many national legal systems provide for judicial review of acts of administrative organs and public entities. In several of those legal systems judicial review is provided in addition to administrative review, while in other systems only judicial review is provided. Some legal systems provide only administrative review, and not judicial review. In some legal systems where both administrative and judicial review is provided, judicial review may be sought only after opportunities for administrative review have been exhausted; in other systems the two means of review are available as options.

G. Record of selection proceedings

134. In order to ensure transparency and accountability and to facilitate the exercise of the right of aggrieved bidders to seek review of decisions made by the contracting authority, the contracting authority should be required to keep an appropriate record of key information pertaining to the selection proceedings.

135. The record to be kept by the contracting authority should firstly contain, as appropriate, such general information concerning the selection proceedings as is usually required to be recorded for public procurement (e.g. the information listed in article 11 of the UNCITRAL Model Law), including the following:

(a) A description of the project for which the contracting authority requested proposals;

(b) The names and addresses of the companies participating in bidding consortia and the name and address of the members of the bidders with whom the project agreement is entered into;

(c) Information relative to the qualifications, or lack thereof, of bidders; a summary of the evaluation and comparison of proposals including the application of any margin of preference;

(d) The price, or the basis for determining the price, and a summary of the other principal terms of the proposals and of the project agreement;

(e) A summary of any requests for clarification of the preselection documents or the request for proposals, the responses thereto, as well as a summary of any modification of those documents;

(f) If all proposals were rejected, a statement to that effect and the grounds therefor.

136. In addition to the above information, it may be useful to require the contracting authority to include the following information in the record of the selection proceedings:

(a) A summary of the conclusions of the preliminary feasibility studies commissioned by the contracting authority and a summary of the conclusions of the feasibility studies submitted by the qualified bidders;

(b) The list of the preselected bidders;

(c) If changes to the composition of the preselected bidders are subsequently permitted, a statement of the reasons for authorizing such changes and a finding as to the qualifications of the new members or members admitted to the consortia concerned;

(d) If the contracting authority finds most advantageous a proposal other than the proposal offering the lowest unit price for the expected output, a justification of the reasons for such finding by the awarding committee;

(e) If the negotiations with the consortium that submitted the most advantageous proposal and any subsequent negotiations with remaining responsive consortia did not result in a project agreement, a statement to that effect and of the grounds therefor.

137. For selection proceedings involving direct negotiations (see paras. 95-107) it may be useful to include the following information in the record of the selection proceedings:

(a) A statement of the grounds and circumstances on which the contracting authority relied to justify the direct negotiation;

(b) The name and address of the company or companies invited to those negotiations;

(c) If those negotiations did not result in a project agreement, a statement to that effect and of the grounds therefor.

138. For selection proceedings engaged in as a result of unsolicited proposals (see paras. 108-128) it may be useful to include in the record of the selection proceedings the following information, in addition to the information mentioned above:

(a) The name and address of the company or companies submitting the unsolicited proposal and a brief description thereof;

(b) A certification by the contracting authority that the unsolicited proposal was found to be of public interest and involve new concepts or technologies, as appropriate.

139. It is advisable that the rules on record requirements specify the extent and the recipients of the disclosure. Setting the parameters of disclosure involves balancing factors such as: the general desirability, from the standpoint of the accountability of contracting authorities, of broad disclosure; the need to provide bidders with information necessary to permit them to assess their performance in the proceedings and to detect instances in which there are legitimate grounds for seeking review; and the need to protect the bidders' confidential trade information. In view of these considerations, it may be advisable to provide two levels of disclosure, as envisaged in article 11 of the UNCITRAL Model Law. The information to be provided to any member of the general public may be limited to basic information geared to the accountability of the contracting authority to the general public. However, it is advisable to provide for the disclosure for the benefit of bidders of more detailed information concerning the conduct of the selection, since that information is necessary to enable the bidders to monitor their relative performance in the selection proceedings and to monitor the conduct of the contracting authority in implementing the requirements of the applicable laws and regulations.

140. Moreover, appropriate measures should be taken to avoid the disclosure of confidential trade information of suppliers and contractors. That is true in particular with respect to what is

disclosed concerning the evaluation and comparison of proposals, as excessive disclosure of such information may be prejudicial to the legitimate commercial interests of bidders. As a general rule, the contracting authority should not disclose more detailed information relating to the examination, evaluation and comparison of proposals and proposal prices, except when ordered to do so by a competent court.

141. Provisions on limited disclosure of information relating to the selection process would not preclude the applicability to certain parts of the record of other statutes in the enacting State that confer on the public at large a general right to obtain access to Government records. Disclosure of the information in the record to legislative or parliamentary oversight bodies may be mandated pursuant to the law applicable in the host country.

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PRIVATELY FINANCED INFRASTRUCTURE PROJECTS

Draft chapters of a legislative guide on privately financed infrastructure projects

Report of the Secretary-General

Addendum

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LEGISLATIVE RECOMMENDATIONS

Conclusion of the project agreement (see paras. 5-8)

(1) The host country may wish to adopt provisions that simplify the procedures for the conclusion of the project agreement and identify in advance the offices or agencies competent to approve and sign the project agreement.

Financial arrangements (see paras.10-21)

(2) The host country may wish to provide:

(a) That any financing of the infrastructure facility may be in such amounts and upon such terms and conditions as may be determined by the concessionaire and that, for that purpose, the concessionaire may in particular issue debt, equity and other securities or obligations, and secure any financing with a security interest in any of its property;

(b) That the project agreement should provide for tariffs or user fees that may be charged by the concessionaire for the use of the facility or the services it provides, and should set forth the method and formulae for the adjustment of those tariffs or user fees;

(c) That the project agreement should provide for tariffs or user fees that allow for the recovery of the capital invested and the operation and maintenance costs with a reasonable rate of return.

(3) The host country may further wish to provide:

(a) That the contracting authority is authorized, where appropriate, to agree to make direct payments to the concessionaire as a substitute for, or in addition to, service charges to be paid by the users;

(b) That the contracting authority is authorized, where appropriate, to enter into commitments for the purchase of fixed sums of goods or services.

The project site (see paras. 22-27)

(4) The host country may wish to provide:

(a) That the project agreement should specify, as appropriate, which assets will remain the property of the contracting authority or of other governmental agencies and which categories of assets will remain the private property of the concessionaire;

(b) That the compulsory acquisition of any land required for privately financed infrastructure projects should be carried out pursuant to the most efficient proceedings available under the laws of the host country.

Easements (see paras. 28-31)

(5) The host country may wish to adopt legislative provisions that identify the easements that might be needed by the concessionaire.

Security interests (see paras. 32-40)

(6) The host country may wish to provide:

(a) That the concessionaire may create a security in respect of any of its property interests in the infrastructure facility;

(b) That the concessionaire may secure any financing with a pledge of the proceeds and receivables arising out of the concession.

Organization of the concessionaire (see paras. 41-51)

(7) The host country may wish to provide that the selected bidders should establish an independent legal entity with a seat in the country, except for cases where the contracting authority has waived such requirement.

(8) Where the selected bidders are required to establish an independent legal entity, the host country may wish to provide that the project agreement should specify:

(a) The form of the legal entity and its minimum capital;

(b) The procedures for obtaining the approval of the contracting authority to fundamental changes in the statutes and by-laws of the concessionaire company, which approval should not be unreasonably withheld.

Assignment of the concession (see paras. 52-55)

(9) The host country may wish to require that the project agreement set forth the conditions under which the contracting authority may give its consent to the assignment of a concession, including:

(a) Acceptance by the new concessionaire of all obligations under the project agreement;

(b) Evidence of the new concessionaire's technical and financial capability as necessary for providing the service.

Transferability of shares of the project company (see paras. 56-63)

(10) The host country may wish to provide that the transfer of equity participation in the capital of a concessionaire company may require the consent of the contracting authority if:

(a) The concessionaire is in the possession of public assets or assets which the concessionaire is required to hand over to the contracting authority at the end of the concession period; or

(b) The concessionaire has received or benefited from loans, subsidies, equity or other forms of direct financial support by the Government.

Duration of the project agreement (see paras. 64-67)

(11) The host country may wish to provide that all concessions should have a limited duration, which should be specified in the project agreement, taking into account the nature and amount of investment required to be made by the concessionaire.

NOTES ON LEGISLATIVE RECOMMENDATIONS

A. General considerations

1. The "project agreement" between the Government and the concessionaire is the central document in an infrastructure project. The project agreement defines the scope and purpose of the project as well as the rights and obligations of the parties; it provides details on the execution of the project and sets forth the conditions for the operation of the infrastructure or the delivery of the relevant services. Project agreements may be contained in one single document or may consist of more than one separate agreement between the contracting authority and the concessionaire. This section discusses the relation between the project agreement and the host country's legislation on privately financed infrastructure projects. It also discusses procedures and formalities for the conclusion and entry into force of the project agreement.

1. Legislative approaches

2. The project agreement is the instrument through which the Government exercises its authority to entrust a concessionaire with the responsibility to carry out an infrastructure project (see chapter I, "General legislative considerations", ___). Therefore, there is an intrinsic link between the project agreement and the laws of the host country that govern the execution of privately financed infrastructure projects or, more generally, the provision of public services. Domestic legislation often contains provisions dealing with the content of the project agreement. In this respect, three main approaches have been used. While the laws of some countries merely refer to the need for an agreement between the concessionaire and the contracting authority, the laws of other countries contain extensive mandatory provisions concerning the content of clauses to be included in the agreement. An intermediate approach is taken by those laws that list a number of issues that need to be addressed in the project agreement without regulating in detail the content of its clauses.

3. Legislative provisions on certain essential elements of the project agreement may serve the purpose of establishing a general framework for the allocation of rights and obligations between the parties. They may be intended to ensure consistency in the treatment of certain contractual issues and to provide guidance to the public authorities involved in the negotiation of project agreements at different levels of Government (national, provincial or local). Such guidance may be found particularly useful by contracting authorities lacking experience in the negotiation of project agreements. Some countries may further consider that legislative provisions on certain elements of the project agreement may enhance the contracting authority's negotiating position vis-à-vis the concessionaire. Lastly, legislation may sometimes be required so as to provide the contracting authority with the power to agree on certain types of provisions.

4. The possible disadvantage of legislative provisions dealing in detail with the rights and obligations of the parties is that they might deprive the contracting authority and the concessionaire of the necessary flexibility to negotiate an agreement that takes into account the needs and particularities of a specific project. Therefore, it is advisable to limit the scope of legislative provisions concerning the project agreement to those strictly necessary, such as, for instance,

provisions on matters for which prior legislative authorization might be needed or those that might affect the interests of third parties or provisions relating to essential policy matters on which variation by agreement is not admitted.

2. Conclusion of the project agreement

5. For projects as complex as infrastructure projects, it is not unusual that several months elapse in negotiations before the parties are ready to sign the project agreement. A number of factors have been reported to cause delay in the negotiations, such as inexperience of the parties, poor coordination between different governmental agencies, uncertainty as to the extent of governmental support, or difficulties in establishing security arrangements acceptable to the lenders.1/ In order to avoid unnecessary delay in the conclusion of the project agreement, it is advisable to have rules in place that identify clearly the persons or offices that have the authority to enter into commitments on behalf of the contracting authority (and, as appropriate, of other agencies of the Government) at different stages of negotiation and to sign the project agreement. For projects involving offices or agencies at different levels of government (e.g. national, provincial or local), where it may not be possible to identify in advance all the relevant offices and agencies involved, other measures may be needed to ensure appropriate coordination among them (see chapter I, "General legislative considerations", ___).

6. Moreover, a significant contribution may be made by the Government by providing adequate guidance to negotiators acting on behalf of the contracting authority. The clearer the understanding of the parties as to the matters to be provided in the project agreement, the greater the chances that the negotiation of the project agreement will be conducted successfully. Conversely, where important issues remain open after the selection process and little guidance is provided to the negotiators as to the substance of the project agreement, there might be considerable risk of costly and protracted negotiations as well as of justified complaints that the selection process was not sufficiently transparent and competitive (see further chapter III, "Selection of the concessionaire", ___).

7. In addition to practical arrangements to facilitate the negotiation of the project agreement, it is important to consider measures to expedite its conclusion. Some national laws prescribe certain formalities for the conclusion and entry into force of project agreements. In some countries the terms of the agreement negotiated between the contracting authority and the selected bidders may be subject to approval by a higher authority. The entry into force of the project agreement or of certain categories of project agreements is in some countries subject to an act of parliament or even the adoption of special legislation.

8. With a view to expediting matters and avoiding the adverse consequences of delays in the project's timetable, in some countries the authority to bind the contracting authority or the

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1/ For a discussion of issues having an impact on achieving financial closure, see International Finance Corporation, *Financing Private Infrastructure*, Washington, D.C., 1996, p. 37.

Government, as appropriate, is delegated in the relevant legislation to designated officials, so that the entry into force of the project agreement occurs upon signature or upon the completion of certain formalities, such as publication in the official gazette. In countries where such a procedure might not be feasible, or in which final approvals by another entity would still be required, it would be desirable to consider ways to avoid unnecessary delay. It is important to bear in mind that the risk of the project being frustrated by lack of approval after negotiations have been completed is not one that the concessionaire would be ready to assume. Where approval requirements are perceived as arbitrary or cumbersome, the Government might be requested to provide sufficient guarantees to the concessionaire and the lenders against such risk (see chapter II, "Project risks and Government support", ___). In some countries where those approval requirements exist, Governments have sometimes agreed in the project agreement to compensate the concessionaire for all costs incurred in the event the final approval of a project is withheld for reasons not imputable to the concessionaire.

B. Core terms of the project agreement

9. Project agreements are typically lengthy documents that deal extensively with a wide variety of general and project-specific issues. This section discusses possible legislative implications of what in national laws appear to be core provisions of project agreements, i.e. those that define the essential financial obligations of the parties, the nature of the rights granted to the concessionaire, the project site and the ownership regime in respect of project assets, the organization of the concessionaire and the duration of the project.

1. Financial arrangements

10. The financial arrangements belong to the essential terms of the project agreement. They typically include provisions concerning the concessionaire's obligations for raising funds for the project, outline the mechanisms for disbursing and accounting for funds, set forth methods for calculating and adjusting the prices charged by the concessionaire and deal with the types of security interests that may be established in favour of the concessionaire's creditors. In drafting these provisions care needs to be taken to ensure their consistency with the loan agreements and other financial commitments entered into by the concessionaire. It is further important to ensure that the laws of the host country are conducive or do not pose obstacles to the financial management of the project.

(a) Financial obligations of the concessionaire

11. In privately financed infrastructure projects the concessionaire is typically responsible for raising sufficient financing for the project. In most cases, the contracting authority or other governmental agencies would be interested in limiting their financial obligations to those specifically expressed in the project agreement or those forms of direct support that the Government has agreed to extend to the project (see chapter II, "Project risks and Government support", ___).

12. The amount of private capital contributed directly by the project company's shareholders typically represents only a portion of the total proposed investment. A far greater portion derives from loans extended to the concessionaire by commercial banks and from the proceeds of the placement of bonds and other negotiable instruments on the capital market (see "Introduction and background information on privately financed infrastructure projects", ___). Therefore, it may be useful for the law to acknowledge the concessionaire's authority to enter into the financial arrangements it sees fit for the purpose of financing the infrastructure. It is further important to ensure that the laws of the host country will not unreasonably restrict the concessionaire's ability to conclude the necessary financing arrangements, for instance by limiting the concessionaire's ability to offer adequate security to its lenders (see paras. 32-40).

13. The revenue obtained with the placement of bonds and other negotiable instruments may represent a substantial source of financing for infrastructure projects. Those instruments may be issued by the concessionaire itself, in which case the investors purchasing the security will become its creditors, or they may be issued by a third party to whom the project receivables (see para. 39) have been assigned through a mechanism known as "securitization". Securitization involves the creation of financial securities backed by the project's revenue stream, which is pledged to pay the principal and interest of that security. Securitization transactions usually involve the establishment of a legal entity separate from the concessionaire and especially dedicated to the business of securitizing assets or receivables. This legal entity is often referred to as "special purpose vehicle". The concessionaire assigns project receivables to the special purpose vehicle, which, in turn, issues to investors interest-bearing instruments that are backed by the project receivables. The securitized bondholders acquire thereby the right to the proceeds of the concessionaire's transactions with its customers. The concessionaire collects the tariffs from the customers and transfers the funds to the special purpose vehicle which then transfers it to the securitized bondholders. In some countries, recent legislation has expressly recognized the concessionaire's authority to assign project receivables to a special purpose vehicle, who holds and manages the receivables in trust to the benefit of the project's creditors. With a view to protecting the bondholders against the risk of insolvency of the concessionaire, it may be advisable to adopt the necessary legislative measures to enable the legal separation between the concessionaire and the special purpose vehicle.

(b) The concessionaire's authority to charge prices for public services

14. In a number of countries prior legislative authorization may be necessary in order for a concessionaire to charge a price for the provision of public services or for the use of public infrastructure facilities. Therefore it is desirable that the law contain general provisions authorizing the contracting authority and the concessionaire to agree on the suitable form of payment for the concessionaire, including the right to charge a price for the use of the infrastructure or the service or goods it provides. The absence of such a general provision in legislation has in some countries given rise to judicial disputes challenging the concessionaire's authority to charge a price for the service.

15. In addition to a general recognition of the concessionaire's authority to charge a price for the provision of public services or for the use of public infrastructure facilities, it is important to

consider the level of tariffs and prices that the concessionaire may charge. Tariffs and prices charged by the concessionaire may be the main (sometimes even the sole) source of revenue to pay the investment made in the project in the absence of subsidies or payments by the contracting authority (see paras. 17-21) or the Government (see chapter II, "Project risks and Government support," ___). The concessionaire will therefore seek to be able to set and maintain those tariffs and prices at a level that ensures sufficient cash flow for the project. However, in some legal systems there may be limits to the concessionaire's freedom to establish tariffs and prices. The cost at which public services are provided is typically an element of the Government's infrastructure policy, and a matter of immediate concern for large portions of the public. Thus, the regulatory framework in many countries includes special rules to control tariffs and prices for the provision of public services (see chapter V, "Infrastructure development and operation", ___). Furthermore, statutory provisions or general rules of law in some legal systems establish parameters for pricing goods or services, for instance by requiring that prices meet certain standards of "reasonableness", "fairness" or "equity".

16. Where provisions on the level of tariffs and prices that the concessionaire may charge are deemed necessary, they should seek to achieve a balance between the interests of investors and current and future users. It is advisable that statutory criteria for determining prices take into account, in addition to social factors which the Government regards as relevant, the concessionaire's interest in achieving a level of cash flow that ensures the economic viability and commercial profitability of the project. It may thus be useful for the law to acknowledge that the recovery of the capital and the operation and maintenance cost with a reasonable rate of return is one of the essential elements of a fair tariff system. Furthermore, it is advisable to provide the parties with the necessary authority to negotiate appropriate arrangements, including compensation provisions, in order to address situations where the application of price control rules directly or indirectly related to the provision of public services may result in fixing prices below the level required for the profitable operation of the project (see chapter V, "Infrastructure development and operation", ___).

(c) Financial obligations of the contracting authority

17. Where the concessionaire offers services directly to the general public, the contracting authority or other governmental agency may undertake to make direct payments to the concessionaire as a substitute for, or in addition to, service charges to be paid by the users. Where the concessionaire produces a commodity for further transmission or distribution by another service provider, the contracting authority may undertake to purchase wholesale such commodity at an agreed price and conditions. The main examples of those arrangements are briefly discussed below.

(i) Direct payments

18. Direct payments by the contracting authority have been used in some countries as a substitute for, or as supplement to, payments by the end users, in particular in toll road projects, through a mechanism known as "shadow tolling". Shadow tolls are arrangements whereby the concessionaire assumes the obligation to develop, build, finance and operate a road or another transportation facility for a set number of years in exchange for periodic payments in place of, or in addition to, real or

explicit tolls paid by users. Shadow toll schemes may be used to address risks which are specific to transportation projects, in particular the risk of lower-than-expected traffic levels (see chapter II, "Project risks and Government support", ___). Furthermore, shadow toll schemes may be politically more acceptable than direct tolls, for example where it is feared that the introduction of toll payments on public roads may give rise to protests by road users.

19. Shadow tolls may involve a substantial expenditure for the contracting authority and require close and extensive monitoring by the contracting authority. In countries that have used shadow tolls for the development of new road projects, payments by the contracting authority to the concessionaire are based primarily on actual traffic levels, as measured in vehicle-kilometres. It is considered advisable to provide that payments are not made until traffic begins, so that the concessionaire has an incentive to open the road as quickly as possible. At the same time, it has been found useful to calculate payments on the basis of actual traffic for the duration of the concession, so that the concessionaire also has reason to ensure that the road will need a minimum of disruptive repairs during that time. Alternatively, the project agreement could contain a penalty or liquidated damages clause for lack of lane availability due to repair works calculated. Payment systems used in some countries are further refined by dividing traffic into a number of "bands", with different levels of annual traffic volumes and per-vehicle payments, whereby lower traffic levels entail higher per-vehicle payments, while higher traffic levels cause lower per-vehicle payments. The bands themselves may be increased over time to match anticipated growth in traffic. Separate bands may be established according to the length of the vehicles. The concessionaire is typically required to perform continuous traffic counts to calculate annual vehicle miles, which are verified periodically by the contracting authority. A somewhat modified system may combine both shadow tolls and direct tolls paid by the users. In such a system, shadow tolls are only paid by the contracting authority in the event that the traffic level over a certain period falls below the agreed minimum level necessary in order for the concessionaire to operate the road profitably.

(ii) Purchase commitments

20. In the case of privately financed facilities that generate goods or services that can be delivered on a long-term basis to an identified purchaser, the concessionaire's exposure to market demand and price risks may by mitigated by contractual arrangements that ensure the purchase of the whole output of the facility or of an agreed minimum portion thereof. When the contracting authority or another governmental entity is the sole customer for the services or goods supplied by the concessionaire, the law sometimes provides that those entities will be under an obligation to purchase such goods and services, at an agreed rate, as they are offered by the concessionaire. Contracts of this type are usually referred to as "off-take agreements" and are frequently, but not exclusively, used to support the development of power generation plants by independent power producers. Off-take agreements often include two types of payments: payments for the availability of the production capacity and payments for units of actual consumption. In a power generation project, for example, the power purchase agreement may contemplate the following charges:

(a) *Capacity charges*. These are charges payable regardless of actual output in a billing period and are calculated to be sufficient to pay all of the concessionaire's fixed costs incurred to

finance and maintain the project, including debt service and other ongoing financing expenses, fixed operation and maintenance expenses and a certain rate of return. The payment of capacity charges is often subject to the observance of certain performance or availability standards.

(b) *Consumption charges*. These charges are not intended to cover all of the concessionaire's fixed costs, but rather to pay the variable or marginal costs that the concessionaire has to bear to generate and deliver a given unit of the relevant service or good (e.g. a kilowatt-hour of electricity). Consumption charges usually are calculated to cover the concessionaire's variable operating costs, such as of fuel consumed when the facility is operating, water treatment expenses and costs of consumables. Variable payments often are tied to the concessionaire's own variable operating costs, or to an index that reasonably reflects changes in operating costs.

21. From the perspective of the concessionaire, a combined scheme of capacity and consumption charges is particularly useful to ensure cost recovery where the transmission or distribution function for the goods or services generated by the concessionaire is subject to a monopoly. However, the capacity charges provided in the off-take agreement should be commensurate with the other sources of generating capacity available to, or actually used by, the contracting authority. High capacity charges place a burden on the contracting authority's purchasing capacity and increase the risk of default or repudiation of the agreement, for instances on grounds of public interest. In order to ensure the availability of funds for payments by the contracting authority under the off-take agreement, it is advisable to consider whether advance budgeting arrangements are required. Payments under an off-take agreement may be backed by a guarantee issued by the host Government or by a national or international guarantee agency (see chapter II, "Project risks and Government support", __).

2. The project site

22. Where a new infrastructure facility is to be built on land owned by the contracting authority, or an existing infrastructure facility is to be modernized or rehabilitated (such as in "modernize-operate-transfer" or "rehabilitate-operate-transfer" projects), it will normally be for the contracting authority, as the owner of such land or facility, to make it available to the concessionaire. The contracting authority may either transfer to the concessionaire title to the land or facilities or retain title thereto, while granting the concessionaire a right to use the land or facilities and build upon it. In addition to the general legislative authority that may be required in order for the contracting authority to transfer public property to the concessionaire or to grant to the concessionaire the right to use such public property (see chapter I, "General legislative considerations", ___), it is important to consider the ownership regime of the various categories of assets that are required to the development and operation of infrastructure facilities, and the procedures for acquiring the property, where it is not already in the contracting authority's possession.

(a) Ownership of project assets

23. In some countries the law provides that the physical infrastructure required to the provision of public services remains the property of the contracting authority. However, during the life of the project the concessionaire may make extensive improvements or additions to the physical

infrastructure originally received from the contracting authority or built by the concessionaire itself. The concessionaire may also acquire various other assets which, without being indispensable or strictly necessary for the provision of the service, may enhance the convenience or efficiency of operating the facility or the quality of the service. In either situation there may be doubts about the ownership in respect of those assets. Clarity in this respect is needed in order to determine the type and extent of security interests that the concessionaire may establish over project assets in order to raise financing for the project (see paras. 34-36). Clarity will be further needed with a view to ensuring an orderly hand-over of assets to the contracting authority or to another concessionaire at the end of the project term in case of "build-operate-transfer" and similar types of projects (see chapter VI, "End of project term, extension and termination", ___). While the law may provide a general definition of categories of assets that should ordinarily remain the property of the contracting authority or of another governmental agency or that are mandatorily required to be handed over to the contracting authority, there may be no compelling need for detailed legislative provisions on this matter. In fact, in various countries it was found sufficient to require in the law that the project agreement specify, as appropriate, which assets will remain the property of the contracting authority or other governmental agency and which categories of assets will remain the private property of the concessionaire.

(c) Acquisition of land required for executing the project

24. Both in cases where the infrastructure facility will be transferred back to the contracting authority or will be permanently owned by the concessionaire, it is advisable that the parties establish the condition of such land and facility at the time it is handed over to the concessionaire. Such determination may reduce disagreements at the time the infrastructure facility is returned to the contracting authority. Therefore, the project agreement should provide for the inspection, measurement and demarcation of such land and existing facility prior to its being transferred or made available to the concessionaire. Further matters which would be typically dealt with in the project agreement include procedures for handing over the land or facilities and the submission of required documentation.

25. The situation may become more complex when the land is not already owned by the contracting authority and needs to be purchased from its owners. In most cases, the concessionaire would not be in the best position to assume the responsibility for purchasing the land needed for the project. The concessionaire may fear the potential delay and expense involved in negotiations with possibly a large number of individual owners and, as necessary in some parts of the world, to undertake complex searches of title deeds and review of chains of previous property transfers so as to establish the regularity of the title of individual owners. Therefore, it is typical for the contracting authority to assume the responsibility for providing the land required for the implementation of the project, so as to avoid unnecessary delay or increase in the project cost as a result of the acquisition of land. The contracting authority may purchase the required land from its owners or, if necessary, acquire it compulsorily. The procedure for the compulsory acquisition of private property against the payment of appropriate compensation to the owners, in accordance with the rules in force in the host country and relevant rules of international law, is referred to in domestic laws by various technical expressions. In the *Guide* it is referred to as "expropriation".

26. Where expropriation procedures are required, various preparatory measures may need to be taken to ensure that construction works are not delayed. In countries where the law contemplates more than one type of expropriation proceeding, it may be desirable to provide that all expropriations required for privately financed infrastructure projects be carried out pursuant to the most efficient of those proceedings, such as the special proceedings that in some countries apply for reasons of compelling public need (see chapter VII, "Governing law", ___).

27. The right to expropriate private property is usually vested in the Government, but the laws of a number of countries also authorize infrastructure operators or public service providers (e.g. railway companies, electricity authorities, telephone companies) to perform certain actions for the expropriation of private property required for providing or expanding their services to the public. Particularly in those countries where the award of compensation to the owners of the property expropriated is adjudicated in court proceedings, it has been found useful to delegate to the concessionaire the authority to carry out certain acts relating to the expropriation, while the Government remains responsible for accomplishing those acts that, under the relevant legislation, are conditions precedent to the initiation of expropriation proceedings. Upon expropriation, title to the land is often vested in the Government, although in some cases the law may authorize the contracting authority and the concessionaire to agree on a different arrangement, taking into account their respective shares in the cost of expropriating the property.

3. Easements

28. Besides the acquisition of property for the construction of the facility, there might be a need for ensuring the concessionaire's access to such property, in cases where the location of the site of the project is such that access to it requires transit on or through the property of third parties. The nature of the project may also be such that it requires the concessionaire to enter property belonging to third parties (e.g. to place traffic signs on adjacent lands; to install poles or electric transmission lines above third parties' property; to install and maintain transforming and switching equipment; to trim trees that interfere with telephonic lines placed on abutting property). The right to use another person's property for a specific purpose or to do work on it is generally referred to in the *Guide* by the word "easement".

29. Easements usually require the consent of the owner of the property to which they pertain, unless such rights are provided by the law. Except for cases where the required easements affect only a small number of adjacent properties, it is usually not an expeditious or cost-effective solution to leave it to the concessionaire to acquire easements directly from the owners of the properties concerned. Instead it is more frequent that those easements are acquired by the Government simultaneously with the expropriation of the project site. The compulsory acquisition of easements is usually subject to essentially the same conditions that apply to the compulsory acquisition of property, namely, the existence of grounds or reasons of public interest and the payment of appropriate compensation in accordance with the rules in force in the host country and relevant rules of international law.

30. A somewhat different alternative might be for the law itself to provide the types of easements given to the concessionaire, without necessarily requiring the expropriation of the property to which

such easements pertain. Such an approach might be used in respect of sector- where the Government deems it possible to determine, in advance, certain minim might be needed by the concessionaire. For instance, a law specific to the powe may lay down the conditions under which the concessionaire obtains a right of cabi of placing and operating basic and distribution networks on property belonging to a right may be needed for a number of measures, such as establishing or placin overhead cables, as well as establishing supporting structures and transform equipment; maintaining, repairing and removing any of those installations; establi along underground or overhead cables; removing obstacles along the wires or c safety zone.

31. Under some legal systems, the concessionaire might be under an obligation t to the owner, as would have been due in the case of expropriation, should the natu be such that the use of the property by its owner is substantially hindered.

4. Security interests

32. Generally, security interests in personal property provide the secured credi two kinds of rights: a property right allowing the secured creditor, in principle property or have a third party repossess and sell it, and a priority right to receive proceeds from the sale of the property in the event of default by the debtor. In practice, lenders negotiate security interests that allow them to foreclose and ta project which they can take over and operate either to restore its economical viabi reselling at an appropriate time or to retaining the project indefinitely and collect a r Furthermore, security may play a defensive or preventive role by ensuring that, i party acquires the debtor's operations (e.g. by foreclosure, in bankruptcy or directl all of the proceeds resulting from the sale of those assets will go first to repaym loans.

33. Security arrangements play a central role in financing infrastructure projects, the financing is structured under the "project finance" modality. The financing docu financed infrastructure projects typically include extensive security arrangements w comprise both security over physical assets related to the project and security ove held by the concessionaire. A few of the main requirements for the successful clos arrangements are discussed below.

(a) Security over physical assets

34. The negotiation of security arrangements required in order for the project financing for the project may be generally facilitated if the laws of the host country e the creation of security interests over the physical assets comprised in the infrastr there may be legal obstacles to the creation of such security interests, in particula remain in the property of the contracting authority or other governmental agency thro

term. If the concessionaire lacks the title to the property it will in many legal systems have no (or only limited) power to encumber such property.

35. Where limitations of this type exist, the law may still facilitate the negotiation of security arrangements for instance by indicating the types of assets in respect of which such security interests may be created or the type of security interests that is permissible. In some legal systems, a concessionaire who is granted a leasehold interest or right to use certain property may create a security interest over the leasehold interest or right to use. Furthermore, security interests may also be created where the concession encompasses different types of public property, such as when title to adjacent land (and not only the right to use it) is granted to a railway company in addition to the right to use the public infrastructure.

36. Where it is possible to create any form of security interests in respect of assets owned by, or required to be handed over to, the contracting authority, or assets in respect of which the contracting authority has a contractual option of purchase (see chapter VI, "End of project term, extension and termination", ___), the law may require the approval of the contracting authority in order for the concessionaire to create such security interests. With a view to facilitating the creation of security, in such a situation, it may be useful to authorize the contracting authority to express such approval by a general provision in the project agreement, rather than requiring specific acts of approval for each asset in respect of which a security interest is created.

(b) Security over intangible assets

37. The main intangible asset in an infrastructure project is the concession itself, i.e. the concessionaire's right to operate the infrastructure or provide the relevant service. In most legal systems, the concession provides its holder with the authority to control the entire project and entitles the concessionaire to earn the revenue generated by the project. Thus, the value of the concession well exceeds the combined value of all of the physical assets involved in a project. Because the concession holder would usually have the right to possess and dispose of all project assets (with the possible exception of those which are owned by other parties, such as assets owned by the contracting authority or other governmental agency), the concession would typically encompass both present and future assets of a tangible or intangible nature. Therefore, the lenders may regard the concession as an essential component of the security arrangements negotiated with the concessionaire. A pledge of the concession itself may have various practical advantages for the concessionaire and the lenders, in particular in legal systems that would not otherwise allow the creation of security over all of a company's assets, or which do not generally recognize non-possessory security interests (see chapter VII, "Governing law", __). These advantages may include: avoiding the need for creating separate security interests for each project asset, allowing the concessionaire to continue to deal with those assets in the ordinary course of business, making it possible to pledge certain assets without transferring actual possession of the assets to the creditors. Furthermore, a pledge of the concession may entitle the lenders, upon occurrence of default by the concessionaire, to avert termination of the project by taking over the concession and making arrangements for continuation of the project under another concessionaire. A pledge of the concession may, therefore, represent a useful complement to or, under certain circumstances, a substitute for a direct agreement between the lenders and the

contracting authority concerning the lenders' step-in rights (see chapter V, "Infrastructure development and operation", ___).

38. However, in some legal systems there may be obstacles to a pledge of the concession in the absence of express legislative authorization. Under various legal systems, security interests may only be created in respect of assets which can be freely transferable by the grantor of the security. Since the right to operate the infrastructure is in most cases not transferable without the consent of the contracting authority (see paras. 52-55), in some legal systems it may not be possible for the concessionaire to create security interests over the concession itself. Recent legislation in some civil law jurisdictions has removed that obstacle by creating a special category of security interest, sometimes referred to by expressions such as "*h[illegible]eca de concesión de obra pública*" or "*prenda de concesión de obra pública*" ("concession mortgage" or "pledge of public works concessions"), which generally provides the lenders with an enforceable security interest covering all of the rights granted to the concessionaire under the project agreement. However, in order to protect the public interest, the law requires the consent of the contracting authority for any measure by the lenders to enforce such right, under conditions to be provided in an agreement between the contracting authority and the lenders. A somewhat more limited solution has been achieved in some common law jurisdictions in which a distinction has been made between the non-transferable right to carry out a certain activity under a governmental licence (i.e. the "public rights" arising under the licence) and the right to claim proceeds received by the licencee (i.e. the latter's "private rights" under the licence).

39. For countries where it may not be legally possible to allow the creation of security interest over the concession itself, it may be useful for the law to expressly authorize the concessionaire to create security interests over the economic rights arising out of the concession or the proceeds therefrom. Those proceeds typically include the tariffs charged to the public for the use of the infrastructure (e.g. tolls on a toll road) or the price paid by the customers for the goods or services provided by the concessionaire (e.g. electricity charges). They may also include the revenue of ancillary concessions. Security of this type is a typical element of the financing arrangements negotiated with the lenders. It may further play an essential role for the issuance of bonds and other negotiable instruments by the concessionaire. Statutory provisions recognizing the concessionaire's authority to pledge the proceeds of infrastructure projects have been included in recent domestic legislation in various legal systems.

(c) Security over shares of the concessionaire

40. The establishment of security interests over the shares of the concessionaire raises, in principle, concerns similar to those raised by an assignment of the concession (see paras. 52-55). Where the concession may not be assigned or transferred without the consent of the contracting authority, the law sometimes prohibits the establishment of security over the shares of the concessionaire. It should be noted, however, that security over the shares of the concessionaire is commonly required by lenders in project finance transactions, and that general prohibitions on the establishment of such security may unnecessarily limit the concessionaire's ability to raise funding for the project. As with other forms of security, it might therefore be useful for the law to authorize the concessionaire's shareholders to create such security, subject to the contracting authority's prior approval where an approval would be required for the transfer of equity participation in the project company (see para. 62).

5. Organization of the concessionaire

41. Project agreements typically contain provisions on the legal status of the concessionaire and deal with the question whether the concessionaire has to be established as an independent legal entity or whether the project may be awarded collectively to a project consortium. Provisions on these matters are often contained in national legislation on privately financed infrastructure projects as well.

42. As understood in business practice, a consortium is a contractual arrangement whereby a group of enterprises undertakes to cooperate in carrying out a project without integrating into an independent legal entity. Consortia have been widely used in the construction industry for the development of large, capital-intensive projects requiring technical expertise in different fields. Consortia are commonly regarded as purely contractual arrangements which do not have a juridical personality of their own. However, there is no uniform legal regime governing consortia. They may fall under different contractual categories provided in national laws, and the legal status of consortia as well as the rights and obligations of their members vary in different legal systems.

43. Forming a project consortium may present some advantages, such as more flexibility in dealings among the consortium members. Avoiding double taxation may also be a reason for choosing not to establish an independent legal entity in the host country, in case there is no bilateral double taxation agreement between the host country and the country or countries where the foreign investors have their residence for taxation purposes. There might also be instances where the contracting authority would wish to retain the possibility of engaging consortia for infrastructure projects, depending on the scale and nature of the project, or with a view to holding all consortium members jointly liable for the entire project.

44. For those countries that wish to retain such possibility, the law might give the awarding authority the option to award the project to a consortium or to require that a separate legal entity be established by the selected project consortium, depending on the needs of the project. However, a number of issues would need to be addressed in the project agreement, and extensive negotiations and detailed provisions might be required to ensure coordination among members of the consortium, adequate liaison with the contracting authority, as well as clarifying the extent of responsibilities and liabilities of each of the members of the consortium for the execution of the project.2/

2/ A brief discussion of issues arising out of contracting construction works with a non-integrated group of enterprises is contained in the *UNCITRAL Construction Legal Guide* (chapter II, "Choice of Contracting Approach", paras. 9-16). Some of the issues mentioned therein might also apply, *mutatis mutandis*, to negotiations concerning privately financed infrastructure projects, including the following: how the difficulty of bringing a claim against consortium members from different countries, should a dispute arise, may be overcome; how the dispute-settlement clause may be formulated so as to enable any dispute between the contracting authority and several or all the members of the consortium to be settled in the same arbitral or judicial proceeding; how guarantees to be given by third parties as security for performance and quality guarantees to be given by members of the consortium are to be structured; what ancillary agreements may have to be entered into by

45. More common, however, is for the concessionaire to be established as an independent legal entity. From the perspective of the contracting authority, an independent legal entity facilitates coordination in the execution of the project and may provide a mechanism for protecting the interests of the project, which may not necessarily coincide with the individual interests of all of the consortium members. This aspect may be of particular importance where significant portions of the services or supplies required by the project are to be provided by members of the project consortium. Since a substantial part of the liabilities and obligations of the concessionaire, including long-term ones (project agreement, loan and security agreements, construction contracts), are usually agreed upon at an early stage, the project may benefit from being independently represented at the time those instruments are negotiated.

46. Entities who receive concessions for the provision of public services are often required to be established as domestic legal entities under the laws of the host country. Given the public interest in the concessionaire's activities, the contracting authority may wish that the concessionaire comply with national accounting and publicity provisions (e.g. publication of financial statements; publicity requirements concerning certain corporate acts). However, such a requirement emphasizes the need for the host country to have adequate company laws in place (see chapter VII, "Governing law", ___). The ease with which the concessionaire can be established, with due regard to reasonable requirements deemed to be of public interest, may help to avoid unnecessary delay in the implementation of the project.

47. The appropriate time for the establishment of the concessionaire is a matter to be considered in the light of the different interests involved in a typical project. Moved by the interest to start the implementation phase as soon as possible, some contracting authorities might be inclined to require that the concessionaire be established at the earliest possible stage. However, it should be borne in mind that firm and final commitments by the lenders and other capital providers typically may not be available prior to the final award of the concession, particularly where a separate legal entity is the envisaged vehicle for raising funds for the project, such as in a "project finance" transaction (see "Introduction and background information on privately financed infrastructure projects", paras. ___). Therefore, where the contracting authority requires the establishment of an independent legal entity by the members of the selected bidding consortium to carry out the project, it is generally advisable to require that the concessionaire be established within a reasonably short period after, but not before, the award of the project.

48. Another important issue in connection with the organization of the concessionaire concerns the equity investment required for the establishment of the concessionaire. The contracting authority has a legitimate interest in seeking an equity level that ensures a sound financial basis for the concessionaire and guarantees its capability to meet its obligations. The total investment needed as well as the ideal proportion of debt and equity capital vary from project to project so that it would normally be difficult to establish a fixed sum or percentage that would be adequate for all instances. Thus, it may be undesirable to provide a legislative requirement of a fixed sum as minimum capital

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the contracting authority; whether there are any mandatory rules of the law governing an agreement with a group of contractors.

for all companies carrying out infrastructure projects in the country. A more flexible approach might be to indicate the minimum capital required for the establishment of the concessionaire as an ideal percentage of the total project cost in the request for proposals. Where the contracting authority prefers to negotiate the amount or ratio of equity investment offered by the selected bidding consortium, the contracting authority might prefer to have the flexibility to arrive at an adequate minimum capital in the course of the selection process.

49. In addition to the question of minimum capital, national laws may contain provisions concerning the form under which the concessionaire has to be organized. Some laws specifically require that the concessionaire be incorporated as a certain type of company, while other laws make no provision on this subject. In cases where it is considered important to specify the form in which the concessionaire is to be established, it is desirable to bear in mind the interest of the consortium members in ensuring that their liability will be limited to the amount of their investment. In order to avoid a subsidiary liability for payment of the concessionaire's debts, its shareholders will normally prefer a corporate form in which their liability is limited to the value of their shares in the company's capital, such as a joint stock company. They would not be ready to carry out a project that would require them to assume unlimited liability for the concessionaire's debts.

50. Some laws contain provisions concerning the scope of activities of the concessionaire, requiring, for instance, that they be limited to the development and operation of a particular project. Such restrictions might serve the purpose of ensuring the transparency of the project's accounts and preserving the integrity of its assets, by segregating the assets, proceeds and liabilities of this project from those of other projects or other activities not related to the project. Also, such a requirement may facilitate the assessment of the performance of each project since deficits or profits could not be covered with, or set off against, debts or proceeds from other projects or activities.

51. The contracting authority might also wish to be assured that the statutes and by-laws of the concessionaire will adequately reflect the obligations assumed by the company in the project agreement. Therefore, project agreements sometimes provide that the entry into force of changes in the statutes and by-laws of the concessionaire is effective upon approval by the contracting authority. Where the contracting authority or another governmental agency participates in the concessionaire, provisions are sometimes made to the effect that certain decisions necessitate the positive vote of the contracting authority in the shareholders' or board's meeting. In any event, it is important to weigh the public interests represented through the Government against the need for affording the concessionaire the necessary flexibility for the conduct of its business. The daily management of the project would be impaired if even minor matters concerning the company's internal affairs routinely required prior governmental clearance. Furthermore, requirements of this type may increase the risk of improper pressure being exercised against the concessionaire. Where it is deemed necessary to require the contracting authority's approval to proposed amendments to the statutes and by-laws of the concessionaire it is advisable to limit such a requirement to those cases that concern provisions deemed to be of essential importance (e.g. amount of capital, classes of shares and their privileges, liquidation procedures) and which should be identified in the project agreement.

6. Assignment of the concession

52. Concessions are granted in view of the particular qualifications and reliability of the concessionaire and in most legal systems they are not freely transferable. Indeed, domestic laws often prohibit the assignment of the concession without the consent of the contracting authority. The purpose of these restrictions is typically to ensure the contracting authority's control over the qualifications of infrastructure operators or public service providers.

53. Some countries have found it useful to mention in the legislation the conditions under which an approval to the transfer of a concession prior to its expiry may be granted, such as, for example, acceptance by the new concessionaire of all obligations under the project agreement and evidence of the new concessionaire's technical and financial capability to provide the service. General legislative provisions of this type may be supplemented by specific provisions in the project agreement setting forth the scope of those restrictions, as well as the conditions under which the consent of the contracting authority may be granted. However, it should be noted that these restrictions typically apply to the voluntary transfer of its rights by the concessionaire; they do not preclude the compulsory transfer of the concession to an entity appointed by the lenders, pursuant to a direct agreement between them and the contracting authority, for the purpose of averting termination due to serious default by the concessionaire (see further chapter V, "Infrastructure development and operation", ___).

54. Another situation that may require legislative consideration concerns the transfer, to another entity, of the responsibility to carry out one particular project activity, rather than full assignment of the concession. In cases where the concessionaire is given the right to provide ancillary services, or where the concession involves multiple activities capable of being carried out separately, the concessionaire may wish to engage another entity to carry out some of those activities by way of a partial assignment of its rights under the project agreement. Such a partial assignment is referred to in some legal systems as a "subconcession". Where the concession itself is not transferable, there may be obstacles to a partial assignment without legislative authorization. Under normal circumstances, however, the contracting authority would have no compelling reason for excluding altogether the possibility of subconcessions, provided that it can be satisfied of the reliability and the qualifications of the subconcessionaire.

55. Another related issue concerns the method for selecting a subconcessionaire. Some countries have special rules governing the award of contracts by public service providers, and in some countries the law expressly requires the use of competitive selection procedures for the award of subconcessions. Rules of this type were often adopted at times where nearly all infrastructure was owned and operated by the State, with little or marginal private sector investment. Their purpose was to ensure economy, efficiency, integrity and transparency in the use of public funds. However, in the case of infrastructure projects implemented by privately owned entities, there may no longer be a compelling reason of public interest for prescribing to the concessionaire the procedure to be followed for the award of subconcessions.

7. Transferability of shares of the project company

56. The contracting authority may be concerned that the original members of the bidding consortium maintain their commitment to the project throughout its duration and that the effective control over the concessionaire will not be transferred to entities unknown to the contracting authority. Concessionaires are selected to carry out infrastructure projects at least partly on the basis of their experience and capabilities for that sort of project (see chapter III, "Selection of the concessionaire", ___). Contracting authorities are therefore concerned that, if the concessionaire's shareholders are entirely free to transfer their investment in a given project, there will be no assurance as to who will actually be delivering the relevant services.

57. Restrictions on the transferability of shares in companies providing public services have been introduced in some countries in order to address the contracting authority's legitimate concern about those companies' ability to deliver the relevant service at the agreed standards and conditions. From a legislative perspective, however, it is important to consider the possible disadvantages of imposing limitations on the transferability of investment in concessionaire companies and the adequacy of such limitations to ensure delivery of the services promised.

58. Contracting authorities may draw comfort from the experience that the selected bidding consortium demonstrated in the pre-selection phase, and from the performance guarantees provided by the parent organizations of the original consortium and its sub-contractors. In practice, however, the comfort that may result from the apparent expertise of the shareholders in the concessionaire should not be overemphasized. Where a separate legal entity is established to carry out the project, which is often the case (see paras. 41-51), the backing of the concessionaire's shareholders, should the project run into difficulties, may be limited to their minimum liability. Thus, restrictions on the transferability of investment, in and of themselves, may not represent sufficient protection against the risk of performance failure by the concessionaire. In particular, these restrictions are not a substitute for appropriate contractual remedies under the project agreement, such as monitoring of the level of service provided (see chapter V, "Infrastructure development and operation", ___), termination without full compensation in case of unsatisfactory performance (see chapter VI, "End of project term, extension and termination", ___), or for the substitution of the project company by another concessionaire appointed by the lenders under a direct agreement with the contracting authority (see chapter V, "Infrastructure development and operation", ___).

59. It should also be noted that, to a certain extent, concerns about the concessionaire's ability to perform satisfactorily under the project agreement are not unique to the contracting authority. The partners of the concessionaire, including the lenders, will be as concerned as the contracting authority to ensure that the designer, the construction contractor and the operating company meet their obligations under the project agreement. In practice, contractual guarantees, performance bonds or insurance policies (see chapter V, "Infrastructure development and operation", ___) may be more effective in protecting against future non-performance than the forced retention of investment by a defaulting partner.

60. In addition to the above, restrictions on the transferability of shares in companies providing public services may also present some disadvantages for the contracting authority. Limitations on the private sector's freedom to the transfer of its equity participation in privately financed infrastructure projects may also limit the variety of investment types and investors, thus reducing the chances of lowering the cost of funding. From a long-term perspective, the development of a market place for investment in public infrastructure may be hindered if investors are unnecessarily constrained in the freedom to transfer their interest in privately financed infrastructure projects.

61. As noted earlier (see "Introduction and background information on privately financed infrastructure projects", ___), there are numerous types of funding available from different investors for different risk and reward profiles. The initial investors, such as construction companies and equipment suppliers, will seek to be rewarded for the higher risks which they take on, while subsequent investors may require a lesser return commensurate with the reduced risks they bear. Most of the initial investors have finite resources and need to recycle capital in order to be able to participate in new projects. Therefore, those investors would typically avoid tying up capital in long term projects. At the end of the construction period, the initial investors might prefer to sell their interest on to a secondary equity provider whose required rate of return is less. Once usage is more certain, another refinancing could take place. However, if the investors' ability to invest and re-invest capital for project development is restricted by constraints on the transferability of shares in infrastructure projects, there is a risk of a higher cost of funding. In some circumstances it may not be possible to fund a project at all, as some investors whose involvement may be crucial for the implementation of the project might not be willing to participate.

62. For the above reasons, it may be advisable to limit the restrictions on the transfer of shares of concessionaire companies to situations where such restrictions are justified by compelling reasons of public interest. One such situation may be where the contracting authority or other agency of the Government has entrusted a concessionaire with public assets (see para. 23), or where the concessionaire receives loans, subsidies, equity or other forms of direct governmental support (see chapter II, "Project risks and Government support", ___). In these cases, the contracting authority's accountability for the proper use of public funds requires assurances that the funds and assets are entrusted to a solid company, to which the original investors remain committed during a reasonable period. Another situation which may justify imposing limitations on the transfer of shares of concessionaire companies may be where the contracting authority has an interest in preventing transfer of shares to particular investors. For example, the contracting authority may wish to control acquisition of controlling shares of public service providers to avoid the formation of oligopolies or monopolies in liberalized sectors (see "Introduction and background information on privately financed infrastructure projects", ___). Or it might not be thought appropriate for a company that had defrauded one part of Government to be employed by another through a newly acquired subsidiary.

63. In these exceptional cases it may be advisable to require that the initial investors seek the prior consent of the contracting authority before transferring their equity participation. It should be made clear in the project agreement that any such consent should not be unreasonably withheld or unduly delayed. For transparency purposes, it may be further advisable to set forth in the law the grounds under which approval may be withdrawn and to require the contracting authority to specify in each

instance the reasons for any refusal. The appropriate duration of such limitations (e.g. whether for a particular phase of the project or for the entire concession term) may need to be considered on a case-by-case basis. In some projects, it may be possible to relax such restrictions after the facility has been completed. It is also advisable to clarify in the project agreement whether these limitations, if any, should apply to the transfer of any participation in the concessionaire, or whether the concerns of the contracting authority will focus on one particular investor (e.g. a construction company or the facility designer) while the construction phase lasts, or for a significant time beyond.

8. Duration of the project agreement

64. The laws of some countries contain provisions that limit the duration of infrastructure concessions to a certain number of years. Some laws establish a general limit for most infrastructure projects, and special limits for projects in particular infrastructure sectors. In some countries there are maximum duration periods only for certain infrastructure sectors.

65. The desirable duration of a project agreement may depend on a number of factors, such as: the operational life of the facility; the period during which the service is likely to be required; the expected useful life of the assets associated with the project; how changeable is the technology required for the project; the time needed for the concessionaire to repay its debts and amortize the initial investment. Given the difficulty of establishing a single statutory limit for the duration of infrastructure projects, it is advisable to consider adopting statutory solutions that afford the contracting authority some flexibility to negotiate, in each case, a term that is appropriate to the project in question.

66. In some legal systems, this result is achieved by provisions which require that all concessions should be subject to a maximum duration period, without specifying any number of years. Sometimes the law only indicates which elements are to be taken into account for determining the duration of the concession (e.g. nature and amount of investment required to be made by the concessionaire, the normal amortization period for the particular facilities and installations concerned). Some project or sector-specific laws provide for a combined system requiring that the project agreement should provide for the expiry of the concession at the end of a certain period, or once the debts of the concessionaire have been fully repaid and a certain revenue, production or usage level has been achieved, whichever is the earliest.

67. However, where it is found necessary to adopt statutory limits, the maximum period should be sufficiently long to allow the concessionaire to fully repay its debts and to achieve a reasonable profit. Furthermore, it may be useful to authorize the contracting authority, in exceptional cases, to agree to longer concession periods, taking into account the amount of the investment and the required recovering period, and subject to special approval procedures.

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